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# Charitable Nonprofits' Use of Noncompetition Agreements: Having the Best of Both Worlds

Lindsey D. Blanchard

*University of St. Thomas School of Law*

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## ARTICLE

CHARITABLE NONPROFITS' USE OF  
NONCOMPETITION AGREEMENTS:  
HAVING THE BEST OF BOTH WORLDS

LINDSEY D. BLANCHARD\*

## INTRODUCTION

For years, individuals have been challenging the noncompetition agreements they entered into with their employers on the basis that the agreements violate public policy. However, in a competitive marketplace—where every person is out for him or herself and the goal is to maximize profits—courts and legislatures in many jurisdictions are reluctant to invalidate otherwise reasonable noncompetition agreements. After all, companies should have the right to expect that freely-negotiated contract provisions will be enforced.

But what if the noncompetition agreement is entered into between an individual and a nonprofit organization? Should the nonprofit organization have the same right of expectation? For the most part, the courts and legislatures seem to think so. And, perhaps they are right, at least when it comes to the general class of nonprofits and to nonprofits that are protecting their interests against for-profit entities. As for *charitable*—or § 501(c)(3)—nonprofits that are attempting to protect their interests against other *charitable* nonprofits, however, the decision-making bodies should reconsider their position.

Unlike traditional for-profit entities, whose main goal is profit maximization, charitable nonprofits are organized and operated to benefit

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\* Visiting Assistant Professor, University of St. Thomas School of Law (Minneapolis, Minnesota). I would like to give special thanks to my research assistant, James Todd, and to Professors Bradley G. Clary (University of Minnesota Law School) and Scott Taylor (University of St. Thomas School of Law) for their feedback and support.

some greater good. As a result, charitable nonprofits receive donations from philanthropic individuals and corporations, as well as various tax breaks from the government, which are unavailable to for-profit entities. At the same time, charitable nonprofits exploit many of the same tools that for-profit firms utilize to maximize profits, including noncompetition agreements. Thus, charitable nonprofits are able to benefit from an anti-competition, profit-maximizing tool while also reaping the rewards of their tax-exempt status. In short, charitable nonprofits wrongly enjoy the best of both the for-profit and nonprofit worlds.

Part II of this Article discusses charitable nonprofits, focusing on their unique philanthropic missions and the tax benefits conferred on them by the federal and state governments. Part III provides a general overview of employee noncompetition agreements. Part IV demonstrates that charitable nonprofits' use of noncompetition agreements is contrary to their missions and tax-exempt statuses, as well as to the public interest, because the noncompetition agreements restrict individuals' abilities to serve society. Moreover, alternative and less intrusive means of protecting an employer's interests exist. Finally, Part IV proposes that Congress should adopt a law rendering unenforceable any language in a noncompetition agreement that would prevent an individual from leaving the employment of one charitable nonprofit for employment at another.<sup>1</sup>

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<sup>1</sup> Taking this argument a step further to state that charitable nonprofits should not be allowed to use noncompetition agreements *at all*—whether dealing with other charitable nonprofits or for-profit entities—while not the topic of this Article, also may be worth considering. The charitable nonprofits' foray into the for-profit world of competition has some people concerned about the organizations' ability to maintain their mission focus. CRISTIANA CICORIA, NONPROFIT ORGANIZATIONS FACING COMPETITION: THE APPLICATION OF UNITED STATES, EUROPEAN AND GERMAN COMPETITION LAW TO NOT-FOR-PROFIT ENTITIES 34 (2006) (noting that competition with for-profit firms can “lead nonprofits to adopt business-like practices, and to lose the focus on noncommercial/altruistic missions”); W. HARRISON WELLFORD & JANNE G. GALLAGHER, UNFAIR COMPETITION? THE CHALLENGE TO TAX EXEMPTION ix (1988) (stating that some nonprofits have “los[t] sight of the fact that they are, in fact, *not* for profit”). For example, competition with for-profit firms can lead to commercialization. See Howard P. Tuckman, *Competition, Commercialization, and the Evolution of Nonprofit Organizational Structures*, 17 J. POL'Y ANALYSIS & MGMT. 175, 177 (1998). In other words, in order to stay in business, a charitable nonprofit may decide to produce some goods or services for the sole purpose of generating a profit. *Id.* at 177, 186. Over time, this increase in commercial activity likely will draw the organization's attention away from its chief activities. See *id.* at 190. Thus, “[t]he challenge for public policy is to insure that . . . the pressures toward commercialization[] do not diminish the unique charitable role of the nonprofit sector.” *Id.* at 176; see also Burton A. Weisbrod, *Guest Editor's Introduction: The Nonprofit Mission and Its Financing*, 17 J. POL'Y ANALYSIS & MGMT. 165, 173 (1998) (“At present, public policy is permissive in its regulations as they affect nonprofits' access to commercial markets. But the social disadvantages of having nonprofits act increasingly like private firms are considerable.”). When charitable nonprofits lose sight of their mission focus, they should no longer

## I. A BRIEF OVERVIEW OF CHARITABLE NONPROFIT ORGANIZATIONS

The nonprofit sector is made up of a variety of players, but as of 1991, almost half of all nonprofits were charitable nonprofits.<sup>2</sup> As of 2000, that percentage had risen to two-thirds.<sup>3</sup> The term “charitable nonprofits” refers to those entities which satisfy the conditions set forth in § 501(c)(3) of the Internal Revenue Code.<sup>4</sup> Section 501(c)(3) entities are:

[c]orporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private

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be allowed to reap the tax benefits of their nonprofit status. In fact, the Internal Revenue Service and state tax authorities have begun to more closely monitor charitable nonprofits' charitable activities. James R. Hines Jr. et al., *The Attack on Nonprofit Status: A Charitable Assessment*, 108 MICH. L. REV. 1179, 1182 (2010).

<sup>2</sup> WILLIAM G. BOWEN ET AL., *THE CHARITABLE NONPROFITS: AN ANALYSIS OF INSTITUTIONAL DYNAMICS AND CHARACTERISTICS* 5 & fig.1.1 (1994) (showing that, according to the IRS Annual Report dated September 1991, there were 516,554 § 501(c)(3) nonprofits and 538,991 non-§ 501(c)(3) nonprofits). The percentage was roughly the same five years later. See Peter Dobkin Hall, *A Historical Overview of Philanthropy, Voluntary Associations, and Nonprofit Organizations in the United States, 1600–2000*, in *THE NON-PROFIT SECTOR: A RESEARCH HANDBOOK*, 32, 52 tbl.2.1 (Walter W. Powell & Richard Steinberg eds., 2d ed. 2006) (citing P.D. HALL AND C.B. BURKE, *HISTORICAL STATISTICS OF THE UNITED STATES: MILLENNIAL EDITION* (2006)) (showing that, as of 1996, there were 1,188,510 nonprofits, 573,265 of which were charitable nonprofits).

<sup>3</sup> Elizabeth T. Boris & C. Eugene Steuerle, *Scope and Dimensions of the Nonprofit Sector*, in *THE NON-PROFIT SECTOR: A RESEARCH HANDBOOK*, *supra* note 2, at 66, 68 & tbl.3.2. In 2000, there were 1,355,894 registered tax-exempt entities in the United States, 819,008 of which were charitable organizations. *Id.* at 68 tbl.3.1. That number does not include religious congregations, which are not required to register. *Id.* at 68. As of the 2008 tax year, there were 1,186,915 active charitable nonprofit organizations recognized by the Internal Revenue Service. Paul Arnsberger & Mike Graham, *Charities, Fraternal Beneficiary Societies, and Other Tax-Exempt Organizations*, 2008, STAT. OF INCOME BULL. 1, 2 (2011), [www.irs.gov/pub/irs-soi/11eofallbulteorg.pdf](http://www.irs.gov/pub/irs-soi/11eofallbulteorg.pdf).

<sup>4</sup> BOWEN ET AL., *supra* note 2, at 4 (stating that § 501(c)(3) organizations are referred to as “‘charitable’ nonprofits”); Boris & Steuerle, *supra* note 3, at 67 (referring to § 501(c)(3) organizations as “charitable organizations” or “‘public benefit’ organizations”); John Simon et al., *The Federal Tax Treatment of Charitable Organizations*, in *THE NON-PROFIT SECTOR: A RESEARCH HANDBOOK*, *supra* note 2, at 267, 268 (citing *Bob Jones Univ. v. United States*, 461 U.S. 574 (1983)) (“The shorthand ‘charitable’ or ‘charity’ is used for these groups, even though it is only one of several adjectives used in §501(c)(3), partly because ‘charitable’ is the residual category used to classify these groups when they do not fit under any of the other adjectives, and partly because the Supreme Court has held that all §501(c)(3) groups must conform to certain fundamental common-law charitable criteria.”).

shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation . . . , and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.<sup>5</sup>

Thus, to qualify for charitable nonprofit status, an entity must be organized and operated for purposes that benefit the greater good (i.e., it must have a charitable mission),<sup>6</sup> must not distribute profits to those in

<sup>5</sup> I.R.C. § 501(c)(3) (West 2014). Section 501(c)(3) organizations were originally limited to religious, educational, charitable, and scientific organizations. BOWEN ET AL., *supra* note 2, at xxxiii. Those designations comport with early definitions of charity. *See id.* at xxx (“St. Thomas Aquinas classified the spiritual acts of charity as to counsel, to sustain, to teach, to console, to save, to pardon, and to pray; the corporal acts of charity as to clothe, to give drink to, to feed, to free from prison, to shelter, to assist in sickness, and to bury.”). Over the years, Congress added organizations that seek to prevent cruelty to children or animals (1918), organizations that serve literary purposes (1921), and organizations that test for public safety (1954). *Id.* at xxxiii. According to one scholar, “[t]hese developments . . . remain consistent with what is probably the best general definition of the term *charity*: activity that tends toward human betterment.” *Id.* Section 501(c)(3) organizations have been described by one prominent scholar as “the innermost circle of exempt organizations.” Henry Hansmann, *The Evolving Law of Nonprofit Organizations: Do Current Trends Make Good Policy?*, 39 CASE W. RES. L. REV. 807, 818 (1988-89) [hereinafter Hansmann, *Evolving Law*]. For a discussion of the history of philanthropic activity and the development of nonprofit organizations in the United States, see Kevin C. Robbins, *The Nonprofit Sector in Historical Perspective: Traditions of Philanthropy in the West*, in THE NON-PROFIT SECTOR: A RESEARCH HANDBOOK, *supra* note 2, at 13, 13–31; Hall, *supra* note 2, at 32–65.

<sup>6</sup> *See, e.g.*, Paul Arnsberger et al., *A History of the Tax-Exempt Sector: An SOI Perspective*, STAT. OF INCOME BULL. 105, 110 (2008), [www.irs.gov/pub/irs-soi/tehistory.pdf](http://www.irs.gov/pub/irs-soi/tehistory.pdf) (“In order to qualify for tax-exempt status, an organization must show that its purpose serves the public good, as opposed to a private interest.”); BOWEN ET AL., *supra* note 2, at xxxii–xxxiii (“[I]t is necessary to distinguish between ‘charitable’ activities, on the one hand, and, on the other hand, ‘noncharitable’ activities defined by the Internal Revenue Code as ‘nonprofit’ and therefore tax-exempt. The latter are of many sorts, with varied purposes that are related to mutuality, self-help, and cooperation or to activities which for special political reasons have been deemed to deserve nonprofit status. . . . [The former are those that engage in] activity that tends toward human betterment.”); Hines Jr. et al., *supra* note 1, at 1181 (stating that § 501(c)(3) “nonprofits must be both organized and operated for specified charitable purposes”); *see also id.* at 1185 (noting that “state law generally requires nonprofits to identify a charitable mission in their organizing documents and operate in furtherance of that mission”); Kenneth B. Orenbach, *A New Twist to an On-Going Debate About Securities Self-Regulation: It’s Time to End FINRA’s Federal Income Tax Exemption*, 31 VA. TAX REV. 135, 139 (2011) (citing Daniel Halperin, *Income Taxation of Mutual Nonprofits*, 59 TAX L. REV. 133, 133 (2006)) (stating that charitable nonprofits “are established to serve the public interest”); Richard Steinberg & Walter W. Powell, *Introduction*, in THE NON-PROFIT SECTOR: A RESEARCH HANDBOOK, *supra* note 2, at 1, 2 (“In the legal sense, charitable organizations include those organizations that help the needy but also include churches, schools, hospitals, and social service organizations, which generally benefit an indefinite class of individuals.”). If an entity is not organized and operated exclusively for one or more purposes as listed in § 501(c)(3), it will not be considered exempt. 26 C.F.R. § 1.501(c)(3)-1(a)(1) (West 2012). To satisfy the organizational test, the entity’s articles of organization must: (a) [l]imit the purposes of such organization to one or more

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control of the entity,<sup>7</sup> and must refrain from participating in politics.<sup>8</sup> In addition, common law provides that a charitable organization may not act contrary to established public policy.<sup>9</sup> Satisfaction of these criteria leads to significant tax benefits under federal and state law,<sup>10</sup> including income and property tax exemptions for the organization and its donors' ability to deduct their gifts from their taxable income.

Perhaps the most important of the above-mentioned attributes is the charitable nonprofit's pursuit of a philanthropic mission. Without that feature, an entity foregoes some of the tax benefits accorded charitable nonprofits, most notably the ability to receive tax-deductible gifts.<sup>11</sup> Thus, whether an organization adopts a charitable mission in order to gain favorable tax status, or favorable tax status is a bonus for an

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exempt purposes; and (b) . . . not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities which in themselves are not in furtherance of one or more exempt purposes." *Id.* § 1.501(c)(3)-1(b)(1)(i). An entity will satisfy the operational test, "only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3)." *Id.* § 1.501(c)(3)-1(c)(1).

<sup>7</sup> See, e.g., BOWEN ET AL., *supra* note 2, at 3 (citing Henry B. Hansmann, *The Role of Nonprofit Enterprise*, 89 YALE L.J. 835, 835-901 (1980) [hereinafter Hansmann, *Role of Nonprofit Enterprise*] ("The most important generic characteristic of a nonprofit organization is its adherence to what Henry Hansmann has called the 'nondistribution constraint,' which prohibits the distribution of profits or residual earnings to individuals who control the entity."); Simon et al., *supra* note 4, at 268 ("With some minor exceptions, . . . what all of the inhabitants of th[e] nonprofit] sector have in common is, first, the 'nondistribution constraint': they are entitled to make profits but are forbidden to distribute these profits to any person or entity (other than another nonprofit organization)—they have, in conventional terms, no 'owners' . . ."); Richard Steinberg, *Economic Theories of Nonprofit Organizations*, in THE NON-PROFIT SECTOR: A RESEARCH HANDBOOK, *supra* note 2, at 117, 118 ("A nonprofit organization is one precluded from distributing, in financial form, its surplus resources to those in control of the organization. By this definition, nonprofit organizations can earn and retain financial surplus ("profits") provided they do not pay dividend checks or their equivalent to the board of directors or top managers."); Hines Jr. et al., *supra* note 1, at 1180 (citing Steinberg & Powell, *supra* note 6, at 1 ("[N]onprofit organizations may have members and other stakeholders, but may not distribute profits to any owner. This means that directors and managers may dictate the use of nonprofit assets, but may not personally profit from those assets.")).

<sup>8</sup> JOHN D. COLOMBO & MARK A. HALL, *THE CHARITABLE TAX EXEMPTION* 21 (1995) (citing *Bob Jones Univ. v. United States*, 461 U.S. 574 (1983)).

<sup>9</sup> *Id.*; Rebecca S. Rudnick, *State and Local Taxes on Nonprofit Organizations*, 22 CAP. U. L. REV. 321, 330 (1993) (citing Trevor A. Brown, *Religious Nonprofits and the Commercial Manner Test*, 99 YALE L.J. 1631, 1632 (1990)). For example, the U.S. Supreme Court upheld the IRS's revocation of exempt status for racially discriminatory schools because the schools were violating clearly-established public policy. COLOMBO & HALL, *supra* note 8, at 21 (citing *Bob Jones Univ. v. United States*, 461 U.S. 574 (1983)).

<sup>10</sup> "[S]tates generally follow the federal scheme . . . Thus state common law generally adopts the view that an entity is not charitable if it engages in private inurement, excess political activity, or violates established public policy." COLOMBO & HALL, *supra* note 8, at 22 (citations omitted).

<sup>11</sup> BOWEN ET AL., *supra* note 2, at xxxii; see *id.* at 5 (stating that "'noncharitable' nonprofits" provide goods and services that benefit a specific membership and are, therefore ineligible for some of the favorable tax treatment afforded charitable organizations).

organization already dedicated to a charitable mission, it is the mission that ultimately defines the organization.

#### A. THE UNIQUE NATURE OF THE CHARITABLE NONPROFIT'S MISSION

In general terms, “mission” means “a strongly felt aim, ambition, or calling.”<sup>12</sup> In the business context, a “mission” defines the basic reason for an organization’s existence.<sup>13</sup> Not only does it describe the organization’s core competencies and goals, but it also identifies the company’s guiding principles and values.<sup>14</sup> In other words, a mission creates a public image and distinguishes the company from its peers.<sup>15</sup> The presence of a mission is an important tool for organizations because it generates employee unity and commitment<sup>16</sup> and provides a foundation for strategic planning.<sup>17</sup> In fact, entities often put their mission in writing as a formal “mission statement” (sometimes called a “vision statement”<sup>18</sup> or “statement of purpose”<sup>19</sup>).

Both nonprofit and for-profit entities utilize mission statements. Thus, the devotion to a mission is not what distinguishes a charitable

<sup>12</sup> *Mission: definition of mission in Oxford Dictionary (American English) (US)*, OXFORD DICTIONARIES, <http://oxforddictionaries.com/definition/mission?region=us&q=mission> (last visited May 1, 2014).

<sup>13</sup> See Gordon T. Butler, *The Law School Mission Statement: A Survival Guide for the Twenty-first Century*, 50 J. LEGAL EDUC. 240, 240 (2000) (A “mission” is the “fundamental reason for an organization’s existence.”); John A. Pearce II & Fred David, *Corporate Mission Statements: The Bottom Line*, THE ACAD. MGMT. EXECUTIVE, 109, 109 (May 1987) (“[A mission statement] specifies the fundamental reason why an organization exists.”).

<sup>14</sup> See Jerome Organ, *Missing Missions: Further Reflections on Institutional Pluralism (or its Absence)*, 60 J. LEGAL EDUC. 157, 159 (2010) (stating that “a mission identifies a set of purposes and values that guide an organization and the members of the organization in making decisions and directing resources”); STEPHEN R. COVEY, *THE 7 HABITS OF HIGHLY EFFECTIVE PEOPLE* 106 (1989) (“[A] *personal mission statement* [is a] philosophy or creed. It focuses on what you want to be (character) and to do (contributions and achievements) and on the values or principles upon which being and doing are based.”) (emphasis in original); Pearce & David, *supra* note 13, at 109 (describing the “eight key components of mission statements” as including “[t]he identification of principal products/services,” “[t]he expression of commitment to survival, growth, and profitability,” and “[t]he specification of key elements in the company philosophy”).

<sup>15</sup> Charles N. Toftoy & Joydeep Chatterjee, *Mission Statements and the Small Business*, BUS. STRATEGY REV., Autumn 2004, at 41, 42; Butler, *supra* note 13, at 240; Organ, *supra* note 14, at 159.

<sup>16</sup> See COVEY, *supra* note 14, at 143 (“An organizational mission statement—one that truly reflects the deep shared vision and values of everyone within that organization—creates a great unity and tremendous commitment. It creates in people’s hearts and minds a frame of reference, a set of criteria or guidelines, by which they will govern themselves.”); Toftoy & Chatterjee, *supra* note 15, at 43.

<sup>17</sup> See Pearce & David, *supra* note 13, at 109; Toftoy & Chatterjee, *supra* note 15, at 43.

<sup>18</sup> Butler, *supra* note 13, at 240.

<sup>19</sup> Pearce & David, *supra* note 13, at 109.

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nonprofit's persona from its for-profit counterparts; rather, it is the nature of the charitable nonprofit's mission that sets it apart.<sup>20</sup> Compare, for example, the mission statements for PepsiCo and Target Corporation (two for-profit entities) with those of the American Red Cross, Mayo Clinic, and Catholic Charities USA (three charitable nonprofit organizations):

PepsiCo

Our mission is to be the world's premier consumer products company focused on convenient foods and beverages. We seek to produce financial rewards to investors as we provide opportunities for growth and enrichment to our employees, our business partners and the communities in which we operate. And in everything we do, we strive for honesty, fairness and integrity.<sup>21</sup>

Target

Our mission is to make Target your preferred shopping destination in all channels by delivering outstanding value, continuous innovation and exceptional guest experiences by consistently fulfilling our Expect More. Pay Less.® brand promise.<sup>22</sup>

American Red Cross

The American Red Cross, a humanitarian organization led by volunteers and guided by its Congressional Charter and the Fundamental Principles of the International Red Cross and Red Crescent Movement, will provide relief to victims of disaster and help people prevent, prepare for, and respond to emergencies.<sup>23</sup>

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<sup>20</sup> See, e.g., Weisbrod, *supra* note 1, at 172–73 (“In the case of [nonprofit] hospitals, the social mission is to care for the indigent, to undertake research that generates widespread knowledge, and to provide such community-benefit services as education about drugs and maternal nutrition—not simply to provide services for paying customers. In the case of [nonprofit] universities, the social mission is the provision of basic research, education of the poor, and dissemination of information.”).

<sup>21</sup> *Our Mission and Values*, PEPSICO, [www.pepsico.com/Purpose/Our-Mission-and-Values](http://www.pepsico.com/Purpose/Our-Mission-and-Values) (last visited May 8, 2014).

<sup>22</sup> *Mission & Values*, TARGET, <https://corporate.target.com/about/mission-values> (last visited May 8, 2014).

<sup>23</sup> *Mission, Vision, and Fundamental Principles*, AMERICAN RED CROSS, [www.redcross.org/about-us/mission](http://www.redcross.org/about-us/mission) (last visited May 8, 2014).



**Mayo Clinic**

To inspire hope and contribute to health and well-being by providing the best care to every patient through integrated clinical practice, education and research.<sup>24</sup>

**Catholic Charities USA**

The mission of Catholic Charities is to provide service to people in need, to advocate for justice in social structures, and to call the entire church and other people of good will to do the same.<sup>25</sup>

While the for-profit entities' mission statements focus on producing top-notch consumer products, providing premium customer service, and maximizing profitability, the charitable nonprofits' mission statements focus on bettering the welfare of society in some particular way.<sup>26</sup> Thus, the charitable nonprofits' mission statements comport with § 501(c)(3) and broadcast the organizations' philanthropic purposes to society at large.

#### B. FAVORABLE TAX TREATMENT AND OTHER BENEFITS PROVIDED TO CHARITABLE NONPROFITS

The public good-oriented missions pursued by charitable nonprofits play a major role in the nonprofits' survival, providing benefits beyond those provided to for-profit organizations with profit-oriented mission statements.<sup>27</sup> In addition to reaping the managerial benefits discussed above, charitable nonprofits' mission statements also attract donors and draw subsidies from private foundations and government agencies.<sup>28</sup>

<sup>24</sup> *Mayo Clinic Mission and Values*, MAYO CLINIC, [www.mayoclinic.org/about/missionvalues.html](http://www.mayoclinic.org/about/missionvalues.html) (last visited May 8, 2014).

<sup>25</sup> *About Us*, CATHOLIC CHARITIES USA, <http://catholiccharitiesusa.org/about-us/> (last visited May 8, 2014).

<sup>26</sup> Of course, for-profits' and nonprofits' mission statements are not always written in such different terms. For example, Microsoft's mission is to "help people and businesses throughout the world realize their full potential." *About Us*, MICROSOFT, [www.microsoft.com/enable/microsoft/mission.aspx](http://www.microsoft.com/enable/microsoft/mission.aspx) (last visited May 8, 2014). That statement contains no specific references to the products and services provided by Microsoft, the superior customer service Microsoft intends to provide, or Microsoft's profit goals. Thus, while Microsoft is one of the biggest for-profit companies in the world, its mission statement sounds like it could have been written for a nonprofit organization.

<sup>27</sup> See Debra C. Minkoff & Walter W. Powell, *Nonprofit Mission: Constancy, Responsiveness, or Deflection?*, in THE NON-PROFIT SECTOR: A RESEARCH HANDBOOK, *supra* note 2, at 591, 591 (citing SHARON OSTER, STRATEGIC MANAGEMENT FOR NONPROFIT ORGANIZATIONS (1995)) ("[M]ission plays a much larger role in nonprofits than in proprietary enterprises.").

<sup>28</sup> See, e.g., Eleanor Brown & Al Slivinski, *Nonprofit Organizations and the Market*, in THE NON-PROFIT SECTOR: A RESEARCH HANDBOOK, *supra* note 2, at 140, 140–41; Organ, *supra* note 14,

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Charitable nonprofits are even able to save money when purchasing other nonprofit entities that share their mission.<sup>29</sup> Moreover, in exchange for the ability to pursue a worthy cause, employees often are willing to work for lower wages (or to forego wages altogether as volunteers) than they would receive in a comparable position at a for-profit enterprise.<sup>30</sup>

The most well-known benefit enjoyed by charitable nonprofits is their favorable tax treatment by both the federal and state governments.<sup>31</sup> Charitable nonprofits have been exempt from federal income taxation since 1894, and they have been exempt from state and local property taxation even longer.<sup>32</sup> In addition, charitable nonprofits often are relieved from paying state income and sales taxes,<sup>33</sup> are permitted to

at 159–60 (donors); Robbins, *supra* note 5, at 13 (“Modern charitable nonprofit organizations owe their inception and continued support to the public-spirited generosity of philanthropists who feel that contributions to the commonwealth are spiritual or moral imperatives.”).

<sup>29</sup> Paul Gertler & Jennifer Kuan, *Does It Matter Who Your Buyer Is? The Role of Nonprofit Mission in the Market for Corporate Control of Hospitals*, 52 J.L. & ECON. 295, 296–97, 304 (2009) (discussing a study of 135 sales of hospitals that occurred between 1999 and 2000 and concluding that a nonprofit buyer will pay less to a nonprofit seller than would a for-profit buyer because of the nonprofit buyer’s mission).

<sup>30</sup> Brown & Slivinski, *supra* note 28, at 141 (stating that “otherwise identical workers may be willing to work in a nonprofit at a lower wage than they would in a similar for-profit firm” because they care about the nonprofit’s mission); see Minkoff & Powell, *supra* note 27, at 591 (stating that a nonprofit’s “goals provide workers and donors with the satisfaction that their values are being put into action”). But see Hines Jr. et al., *supra* note 1, at 1199 (citing Brown & Slivinski, *supra* note 28, at 142) (stating that “the overall wage differential between nonprofits and for-profits is zero”); Laura Leete, *Work in the Nonprofit Sector*, in THE NON-PROFIT SECTOR: A RESEARCH HANDBOOK, *supra* note 2, at 159, 166 (citing Anne E. Preston, *The Market for Human Resources: Comparing the Professional Career Paths in the Public, Private, Nonprofit Sector*, in NONPROFIT ORGANIZATIONS IN A MARKET ECONOMY: UNDERSTANDING NEW ROLES, ISSUES AND TRENDS (David C. Hammack and Dennis R. Young, eds. 1993)) (discussing a study which found that “sectoral exit was higher for [engineers and scientists] working in the nonprofit sector, where they were paid considerably less,” thereby supporting “the idea that young scientists and engineers use the nonprofit sector as a training ground before they go on to more lucrative careers in the for-profit sector”).

<sup>31</sup> Countless sources discuss the tax treatment accorded charitable nonprofit organizations. Because this Article merely offers a brief overview of the subject, only a handful of the available sources are cited.

<sup>32</sup> COLOMBO & HALL, *supra* note 8, at 3 (citing The Revenue Act of 1894, ch. 349, § 32, 28 Stat. 556 (1894); Carroll H. Sierk, *State Tax Exemptions of Non-Profit Organizations*, 19 CLEVE. ST. L. REV. 281, 282 (1970)). See Hansmann, *Evolving Law*, *supra* note 5, at 810 (discussing the history of fiscal and regulatory law for nonprofits between 1850 and 1950). The state statutes and constitutional provisions typically provide the exemptions to religious, educational, and charitable organizations in a manner similar to § 501(c)(3). *Id.* at 20. For a comprehensive discussion of those exemptions, see William R. Ginsberg, *The Real Property Tax Exemption of Nonprofit Organizations: A Perspective*, 53 TEMPLE L. Q. 291, 292 (1980); WELLFORD & GALLAGHER, *supra* note 1, at app. A (providing a 50-state survey of laws governing charitable property tax exemptions).

<sup>33</sup> COLOMBO & HALL, *supra* note 8, at 3, 20 (citing Mark A. Hall & John D. Colombo, *The Charitable Status of Nonprofit Hospitals: Toward a Donative Theory of Tax Exemption*, 66 WASH. L. REV. 307, 323 n.53 (1991); Janne G. Gallagher, *Sales Tax Exemptions for Charitable, Educational, and Religious Nonprofit Organizations*, 7 EXEMPT ORG. TAX REV. 429 (1993)).

issue tax-exempt bonds,<sup>34</sup> are exempt from the Federal Unemployment Tax Act and the federal gambling tax,<sup>35</sup> and can receive tax-deductible donations from their supporters.<sup>36</sup>

While the charitable tax exemption is entrenched in federal law, there is no commonly-accepted explanation for its existence.<sup>37</sup> Historically, tax-based theories were used to justify the exemption.<sup>38</sup> Under such theories, “exemption exists for entities that simply do not have any of what the particular tax system attempts to tax: e.g., no net disposable income or no real property.”<sup>39</sup> Over time, the subsidy theory became the dominant explanation.<sup>40</sup> This theory describes the exemption as “an attempt to help those entities that ‘do good’ for society.”<sup>41</sup> Thus, the subsidy theory is said to more accurately explain the tax system because it assumes the organization falls within the ordinary tax base, but “views the entity as deserving of an implicit government subsidy, which

<sup>34</sup> COLOMBO & HALL, *supra* note 8, at 8.

<sup>35</sup> Simon et al., *supra* note 4, at 269 (citing I.R.C. §§ 3301–11, 4421(2)(b)).

<sup>36</sup> Shannon Weeks McCormack, *Too Close to Home: Limiting the Organizations Subsidized by the Charitable Deduction to Those in Economic Need*, 63 FLA. L. REV. 857, 862 (2011) (citing I.R.C. § 170(a)(1), (c) (West 2010)); BOWEN ET AL., *supra* note 2, at 4 (citing B. A. Weisbrod, THE NONPROFIT ECONOMY 59–79 (1988)); COLOMBO & HALL, *supra* note 8, at 8. The charitable deduction “allows an individual who makes a contribution to a qualifying nonprofit to deduct the amount of that contribution from his or her income when computing personal income tax.” Henry Hansmann, *The Rationale for Exempting Nonprofit Organizations from Corporate Income Taxation*, 91 YALE L.J. 54, 55–56 (1981) [hereinafter Hansmann, *Rationale for Exempting Nonprofit Organizations*] (citing I.R.C. § 170). The rationale behind this benefit is that charitable nonprofits “serve broad public purposes which transcend the personal interests of their members and benefactors.” BOWEN ET AL., *supra* note 2, at 4 (citing B. A. Weisbrod, THE NONPROFIT ECONOMY 59–79 (1988)). Thus, noncharitable nonprofits are not eligible for this benefit. See Simon et al., *supra* note 4, at 269 (“Contributions of cash or property (but not services) to §501(c)(3) charities generally are tax deductible by individuals and corporations for income tax purposes (§170) and are also deductible for estate and gift tax purposes (§§2055, 2522). Gifts to noncharitable nonprofits generally are not deductible . . . .”); Marilyn E. Phelan, 1 NONPROFIT ORGANIZATIONS: LAW AND TAXATION § 7.1 (West 2013) (“Rules differ for each of the classifications of tax exempt organizations. Donations to Section 501(c)(3) organizations provide donors with charitable contribution deductions, whereas contributions to the majority of the other tax exempt organizations do not.”).

<sup>37</sup> COLOMBO & HALL, *supra* note 8, at 4; Orenbach, *supra* note 6, at 188 (citing Nicholas P. Cafardi & Jaclyn Fabean Cherry, UNDERSTANDING NONPROFIT AND TAX EXEMPT ORGANIZATIONS 51 (2006)); Hansmann, *Rationale for Exempting Nonprofit Organizations*, *supra* note 36, at 54.

<sup>38</sup> COLOMBO & HALL, *supra* note 8, at 22.

<sup>39</sup> *Id.*; see, e.g., Simon et al., *supra* note 4, at 273–74; Boris I. Bittker & George F. Rahdert, *The Exemption of Nonprofit Organizations from Federal Income Taxation*, 85 YALE L.J. 299, 304 (1976).

<sup>40</sup> COLOMBO & HALL, *supra* note 8, at 26 (citations omitted) (“Th[e] subsidy theory] is the view of most commentators and it is also the dominant view expressed by courts interpreting the scope of the exemption.”).

<sup>41</sup> *Id.* at 5; see Simon et al., *supra* note 4, at 274–75.

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is administered by foregoing the imposition of taxes.”<sup>42</sup> According to this theory, the subsidy is appropriate because the government would otherwise have to provide the service.<sup>43</sup> Other proposed theories include the capital subsidy theory (which states that nonprofits should be exempt from taxation of their funds because they are hindered from raising money in the first place by the non-distribution constraint),<sup>44</sup> the public benefit theory (which provides that entities should be subsidized for providing common or social goods and services),<sup>45</sup> and the altruism theory (which provides that exemptions are rewards for selfless behavior).<sup>46</sup>

Whatever the rationale, it is clear that charitable nonprofits are reaping significant benefits from the exemptions. In fact, it is estimated that public charities received approximately \$14 billion in income tax

<sup>42</sup> COLOMBO & HALL, *supra* note 8, at 22 (citations omitted).

<sup>43</sup> Orenbach, *supra* note 6, at 189; Hansmann, *Rationale for Exempting Nonprofits*, *supra* note 36, at 66.

<sup>44</sup> Orenbach, *supra* note 6, at 190 (citing Hansmann, *Rationale for Exempting Nonprofit Organizations*, *supra* note 36, at 54–75).

<sup>45</sup> McCormack, *supra* note 36, at 865–66 (quoting William D. Andrews, *Personal Deductions in an Ideal Income Tax*, 86 HARV. L. REV. 309, 357 (1972)); see Alice M. Thomas, *Re-envisioning the Charitable Deduction to Legislate Compassion and Civility: Reclaiming Our Collective and Individual Humanity Through Sustained Volunteerism*, 19 KAN. J.L. & PUB. POL’Y 269, 324–25 (2010) (citing Simon et al., *supra* note 4, at 274).

<sup>46</sup> Orenbach, *supra* note 6, at 191 (citing Michael J. Barry, *A Sensible Alternative to Revoking the Boy Scouts’ Tax Exemption*, 30 FLA. ST. U.L. REV. 137, 152 (2002)); Miranda Perry Fleischer, *Equality of Opportunity and the Charitable Tax Subsidies*, 91 B.U. L. REV. 601, 610–11 (2011) (citing Rob Atkinson, *Altruism in Nonprofit Organizations*, 31 B.C. L. REV. 501, 635 (1990)). In a similar vein, the exemption is justified by Catholic Social Thought principles in that the exemption is viewed as a means of facilitating pursuit of the common good by encouraging selfless behavior and “fostering the exercise of freedom, responsibility, and self-determination.” John F. Coverdale, *The Normative Justification for Tax Exemption: Elements From Catholic Social Thought*, 40 SETON HALL L. REV. 889, 900 (2010). Experts have proffered similar theories to explain the availability of the donee’s charitable deduction. See McCormack, *supra* note 36, at 865–72; Thomas, *supra* note 45, at 323–26. For example, the tax-based rationale provides that the donated amount is no longer available for the donee’s personal consumption and so should not be part of the donee’s taxable income. Thomas, *supra* note 45, at 324 (citing Simon et al., *supra* note 4, at 273). Theories of democracy promotion and pluralism state that the charitable deduction allows individuals to allocate public funds to organizations that may not otherwise receive those funds if they are supported by only a minority of the public. McCormack, *supra* note 36, at 868–69 (citing Miranda Perry Fleischer, *Generous to a Fault? Fair Shares and Charitable Giving*, 93 MINN. L. REV. 165, 189 (2008)); see Fleischer, *supra* note 46, at 611; Thomas, *supra* note 45, at 325 (citing Simon et al., *supra* note 4, at 275). Finally, the altruism theory holds that deductions should be provided to reward the taxpayer for engaging in a selfless activity. McCormack, *supra* note 36, at 868–69 (quoting Boris I. Bittker, *Charitable Contributions: Tax Deductions or Matching Grants?*, 28 TAX L. REV. 37, 60 (1972)); see Thomas, *supra* note 45, at 325 (citing Simon et al., *supra* note 4, at 275).

savings from tax exemptions in 1996 alone.<sup>47</sup> In addition, of the \$117.9 billion in gifts made to charitable nonprofits that same year, approximately \$37.7 billion were due to donors' ability to take a tax deduction.<sup>48</sup> And, in 2010, the amount of private charitable contributions was a staggering \$290.89 billion.<sup>49</sup> Thus, "[i]t is hard to overstate the importance of mission in shaping the economic study of nonprofits."<sup>50</sup>

### C. CHARITABLE NONPROFITS AND NON-TRADITIONAL COMPETITION

Charitable nonprofits are unique members of the marketplace—they “fac[e] the challenge of efficiently balancing margin and mission.”<sup>51</sup> In other words, while their focus is on bettering some aspect of society rather than solely on profit maximization,<sup>52</sup> charitable nonprofits must remain profitable in order to carry out their mission.<sup>53</sup> This means that

<sup>47</sup> Simon et al., *supra* note 4, at 272 (citing Evelyn Brody & Joseph J. Cordes, *Tax Treatment of Nonprofit Organizations: A Two-Edged Sword?*, in NONPROFITS AND GOVERNMENT: COLLABORATION AND CONFLICT 141–75 (Elizabeth T. Boris & C. Eugene Steuerle eds. 1999)). As of 1990, “the value of the exemption [for exempt hospitals was] at \$8.5 billion a year.” COLOMBO & HALL, *supra* note 8, at 8 (citing John Copeland & Gabriel Rudney, *Federal Tax Subsidies for Not-For-Profit Hospitals*, MARCH 1990 TAX NOTES 1559, 1565).

<sup>48</sup> Simon et al., *supra* note 4, at 272 (citing Brody & Cordes, *supra* note 47).

<sup>49</sup> Katie L. Roeger et al., THE NONPROFIT SECTOR IN BRIEF: PUBLIC CHARITIES, GIVING, AND VOLUNTEERING, 2011, URBAN INSTITUTE 1, 4, 5 fig.3 (2011), [www.urban.org/UploadedPDF/412434-NonprofitAlmanacBrief2011.pdf](http://www.urban.org/UploadedPDF/412434-NonprofitAlmanacBrief2011.pdf).

<sup>50</sup> Brown & Slivinski, *supra* note 28, at 140.

<sup>51</sup> CICORIA, *supra* note 1, at 50; see WELLFORD & GALLAGHER, *supra* note 1, at ix (discussing “human services” nonprofits in particular) (“Nonprofit boards and executives must walk a fine line between assuring the organization’s financial stability as contrasted with making financial success the primary measure of organizational success.”).

<sup>52</sup> See, e.g., Steinberg & Powell, *supra* note 6, at 9 (“Nonprofit success is evaluated in terms of mission, rather than a simple bottom line.”); Brown & Slivinski, *supra* note 28, at 140 (“One distinctive feature of nonprofit firms is that they are unlikely to set out simply to maximize profit. They have been granted nonprofit status because of their proclaimed public purpose, and have foresworn the opportunity to distribute profits to owners.”); CICORIA, *supra* note 1, at 14 (stating that nonprofits “represent the ‘good society’, and they embody the ‘caring tradition’ of values and social commitment that seem to have been overwhelmed by the profit motive”); see also Steinberg & Powell, *supra* note 6, at 9 (“Nondistributing organizations are treated differently under our tax and regulatory laws, amplifying their tendencies to depart from profit maximization.”).

<sup>53</sup> See CICORIA, *supra* note 1, at 46 (“Nonprofit organizations can, similarly to commercial enterprises, aggressively seek profits to finance expansion or product development, but their main goal is to better fulfill beneficiaries['] and donors['] expectations through an increased production of social services and goods. In other words, nonprofit organizations, instead of maximizing profits, maximize the socially beneficial/charitable output.”). Thus, while both for-profits and nonprofits must make profits to survive, the difference lies in what the entities can do with those profits. See BOWEN ET AL., *supra* note 2, at 4. Profits earned by nonprofit organizations must either be “retained (as endowment, reserves, or temporarily restricted funds), reinvested (in organizational expansion or the provision of charitable services), or given to other nonprofit organizations (as grants).”

charitable nonprofits may find themselves engaged in competition for profits with a variety of players.<sup>54</sup> While they sometimes compete with for-profit and nonprofit entities for customer-generated profits (by offering a superior or cheaper service—i.e., “traditional” competition),<sup>55</sup> they also receive a large portion of their revenue from donations and grants available only to other nonprofits.<sup>56</sup> Competition for these resources is much different because the charitable nonprofits’ success depends greatly upon their commitment to their mission<sup>57</sup> rather than solely on the attributes of the services rendered. In this respect, charitable nonprofits engage in non-traditional competition.

## II. A BRIEF OVERVIEW OF NONCOMPETITION AGREEMENTS IN THE EMPLOYMENT CONTEXT

In the employment context, a covenant not to compete—or noncompetition agreement—is a promise by an employee not to engage in the same type of business as his or her employer in a given area for a certain amount of time after the employment relationship ends.<sup>58</sup>

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Steinberg, *supra* note 7, at 118 (citing Hansmann, *Role of Nonprofit Enterprise*, *supra* note 7); Arnsberger et al., *supra* note 6, at 113 (“Even though they are considered nonprofit, public charities use net income, the difference between total revenue and total expenses, to expand future programs and increase endowments.”).

<sup>54</sup> See Hines Jr. et al., *supra* note 1, at 1199; Tuckman, *supra* note 1, at 175 (“Competition among nonprofits and between nonprofits and for-profits is a present-day reality.”).

<sup>55</sup> See BLACK’S LAW DICTIONARY 119 (2d pocket ed. 2001) (defining “competition” as “[t]he effort or action of two or more commercial interests to obtain the same business from third parties”); CICORIA, *supra* note 1, at 18 (“[I]n commercial fields, nonprofits directly compete against business-for-profit firms for customers and clients . . . .”); see also *id.* at 31 (“In the case of nonprofit organizations, competition exists when, in the same market, two or more agencies provide the same services and goods, sharing the same altruistic goal.”). For example, nonprofit hospitals compete with for-profit hospitals for patients in some instances.

<sup>56</sup> See Roeger et al., *supra* note 49, at 3, 3 fig. 2 (indicating that public charities received approximately 13.6% of their revenues in 2009 from private contributions and approximately 8.9% from government grants); CICORIA, *supra* note 1, at 18 (“[I]n the charitable-social fields, [nonprofits] compete against other nonprofit organizations for donors and grants.”).

<sup>57</sup> See CICORIA, *supra* note 1, at 31 (“[T]he main difference which distinguishes nonprofits’ competition from competition among for-profit firms is the lack of self-interested motives.”); see also *id.* at 33 (discussing Howard Tuckman’s analysis of nonprofits’ behavior in a competitive market and stating that, in regard to donors, “reputation and effectiveness in complying with the socially beneficial task are considered to be the most useful weapons against other competitors”); Tuckman, *supra* note 1, at 178 (“Donations to nonprofits are determined, in part, by the value donors place on their services; nonprofits with highly valued missions offering services in scarce supply (relative to demand) may find fund-raising easier than do those with less highly valued missions.”).

<sup>58</sup> BLACK’S LAW DICTIONARY 392 (8th ed. 2004); Gillian Lester, *Restrictive Covenants, Employee Training, and the Limits of Transaction-Cost Analysis*, 76 IND. L.J. 49, 49 (2001); Michael J. Hutter, *Drafting Enforceable Employee Non-Competition Agreements to Protect Confidential Business Information: A Lawyer’s Practical Approach to the Case Law*, 45 ALB. L. REV. 311, 312

Variations of noncompetition agreements have been in existence since mediaeval times,<sup>59</sup> and they serve important and useful purposes in a marketplace otherwise guided by principles of free competition. One longstanding purpose is to prevent employees from learning their employers' secrets only to leave and set up a competing business in the employers' backyard.<sup>60</sup> And, as employee mobility continues to increase, employers are using these agreements to prevent employees from taking confidential information learned during their tenure to a new job with a competitor.<sup>61</sup>

Given the apparent benefits conferred by noncompetition agreements, and the principle of freedom of contract<sup>62</sup> upon which American society is based,<sup>63</sup> some would argue that noncompetition agreements should be enforced as long as they are entered into by

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(1980–81); Harlan M. Blake, *Employee Agreements Not to Compete*, 73 HARV. L. REV. 625, 626 (1960). This section of the Article will provide a brief overview of the law regarding employment noncompetition agreements. For more information, see RICHARD A. LORD, 6 WILLISTON ON CONTRACTS § 13 (4th ed.) and DONALD J. ASPELUND & STEPHEN L. LUNDWALL, EMPLOYEE NONCOMPETITION LAW (Westlaw 2011). For an empirical study of noncompetition agreements, see Peter J. Whitmore, *A Statistical Analysis of Noncompetition Clauses in Employment Contracts*, 15 J. CORP. L. 483 (1989–1990).

<sup>59</sup> See Franklin D. Jones, *Historical Development of the Law of Business Competition*, 35 YALE L.J. 905, 920 (1926); LORD, *supra* note 58, § 13.2 (citing a case from the year 1600); Katherine V.W. Stone, *Knowledge at Work: Disputes Over the Ownership of Human Capital in the Changing Workplace*, 34 CONN. L. REV. 721, 760 (2002).

<sup>60</sup> Jones, *supra* note 59, at 921 (citing *United States v. Addyston Pipe & Steel Co.*, 85 Fed. 271, 280 (6th Cir. 1898), *modified on other grounds*, 175 U.S. 211 (1899)); see Hutter, *supra* note 58, at 311–12 (discussing employers' use of noncompetition agreements to prevent serious monetary losses resulting from the transfer of confidential business information to a competitor). Covenants not to compete also have long been used in conjunction with the sale of a business. See Charles E. Carpenter, *Validity of Contracts Not to Compete*, 76 U. PA. L. REV. 244, 245 (1928) (“[T]he English courts early supported agreements not to compete where they were part of a sale of property or a business, and were appropriate as a protection of the property or business retained or sold . . .”). In that instance, the function of the covenant is to maintain honesty and protect business' goodwill by preventing a person from selling his business to an innocent buyer only to turn around and open a rival business across the street. See Jones, *supra* note 59, at 921 (citing *Addyston*, 85 Fed. at 280).

<sup>61</sup> Hutter, *supra* note 58, at 311–12.

<sup>62</sup> “Freedom of contract” is “[t]he doctrine that people have the right to bind themselves legally; a judicial concept that contracts are based on mutual agreement and free choice, and thus should not be hampered by external control . . .” BLACK'S LAW DICTIONARY 689 (8th ed. 2004); see Jeffrey G. Grody, *Partial Enforcement of Post-Employment Restrictive Covenants*, 15 COLUM. J.L. & SOC. PROBS. 181, 195 (1979) (“[F]reedom-of-contract[ is] the notion that private parties should be free to structure mutual agreements with full confidence that the legal system will enforce them.”).

<sup>63</sup> See Whitmore, *supra* note 58, at 486 (“[T]he freedom to contract . . . has been protected by American courts since the early nineteenth century. This doctrine has existed to ‘encourage individual entrepreneurial activity’ and has ‘been extolled as one of the great boons of modern democratic civilization, as one of the principal causes of prosperity and comfort.’”)

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competent parties and are neither illegal nor unconscionable.<sup>64</sup> However, significant public policy concerns are raised by the use of noncompetition agreements—most notably, that they unduly restrain trade.<sup>65</sup> And, employees have been challenging their noncompetition agreements on those grounds for centuries.<sup>66</sup> Under fifteenth-century English common law, for example, covenants not to compete were determined to be wholly unlawful because they “might have the effect of making [the obligor] and his family a charge upon the community as well as depriving the community of the benefit of his competition.”<sup>67</sup> Similarly, in one early United States case, a state court enumerated several reasons for finding noncompetition agreements to be inherently unreasonable, including that they diminish the ability of a person to procure a livelihood, deprive the public of services by those most capable of rendering them, discourage enterprise, and hinder competition.<sup>68</sup>

<sup>64</sup> See Brandon S. Long, Note, *Protecting Employer Investment in Training: Noncompetes vs. Repayment Agreements*, 54 DUKE L.J. 1295, 1302–03 (2005); Maureen B. Callahan, Comment, *Post-Employment Restraint Agreements: A Reassessment*, 52 U. CHI. L. REV. 703, 725–27 (1985).

<sup>65</sup> See Whitmore, *supra* note 58, at 486 (discussing the competing doctrines involved in the noncompetition clause arena—that of freedom to contract and that against restraints of trade).

<sup>66</sup> See Hutter, *supra* note 58, at 312–313 (“In view of the number of decisions reported each year involving . . . non-competition agreements, it also appears to be quite common for employees to breach them and contend that they are illegal.”). For a detailed discussion of the common law origins of post-employment covenants not to compete, see Mark A. Glick et al., *The Law and Economics of Post-Employment Covenants: A Unified Framework*, 11 GEORGE MASON L. REV. 357, 360–368 (2002) and Blake, *supra* note 58, at 629–46.

<sup>67</sup> Jones, *supra* note 59, at 920; see Carpenter, *supra* note 60, at 244–45 (discussing fifteenth- and sixteenth-century English cases and stating that they “seem to make no point of the narrowness of the restriction either as to space or time, but treat all such covenants as void” in part because “an agreement not to carry on a trade or to refrain from competing with the covenantee might have greatly injured the covenantor by divesting him of his only means of earning a livelihood”); *Colgate v. Bachele*, 1600 WL 41 (K.B. 1600), 78 E.R. 1097, (1600) Cro. Eliz. 872 (“[I]t was resolved by the Court, that this condition is against law, to prohibit or restrain any to use a lawful trade at any time, or at any place; for as well as he may restrain him for one time or place, he may restrain him for longer times and more places, which is against the benefit of the commonwealth; for being freemen, it is free for them to exercise their trade in any place.”).

<sup>68</sup> Jones, *supra* note 59, at 920–21 (citing *Alger v. Thacher*, 19 Pick. 51, 54 (Mass. 1837)); see Carpenter, *supra* note 60, at 253 (“[T]he real objections to contracts not to compete are: (1) that they divest the promisor of his means of earning a livelihood and supporting himself and his family; and (2) that they deprive the community of (a) the benefit of his services and (b) the benefit which his competition might offer.”). Those concerns are still present today. See Hutter, *supra* note 58, at 317 (“Most courts, however, approach [non-competition] agreements with great skepticism, recognizing that their enforcement interferes to some extent with an individual’s freedom to pursue his/her calling, and with the mobility of talent within the economy.”); Norman D. Bishara, *Covenants Not to Compete in a Knowledge Economy: Balancing Innovation From Employee Mobility Against Legal Protection for Human Capital Investment*, 27 BERKELEY J. EMP. & LAB. L. 287, 311 (2006) (“Abolishment proponents argue that noncompetes should not be enforced because: (1) they restrain trade and keep important information from the public, (2) they can cause an overall loss to society by depriving it of valuable services, and (3) employees have unequal bargaining



Over time, “as business developed and the value of good will became understood, as individual freedom of movement and action was secured, and as corporations became factors in trade and commerce,” courts began using a reasonableness test to determine whether a particular noncompetition agreement was valid.<sup>69</sup> There are two main considerations under this test:

[F]irst, it is necessary to decide whether the non-competition agreement is reasonably necessary to protect the legitimate needs of the employer; and second, whether the non-competition agreement is reasonable with respect to the nature of the temporal and geographic restraints and the activity proscribed.<sup>70</sup>

Courts also will look to the effect of the agreement on the public interest.<sup>71</sup> Thus, the courts began to balance the competing policies.<sup>72</sup> A

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power and need protection to ensure their ability to pursue a chosen livelihood and mobility.”); Long, *supra* note 64, at 1304–05 (discussing concerns that employment noncompetition agreements are anticompetitive, affect workers’ livelihoods, allow employers to exploit the disparity in bargaining power, and deprive society of individuals’ productivity). *But see* Callahan, *supra* note 64, at 706–07, 712–25 (arguing that the notions that noncompetition agreements are anticompetitive, unfair, and harmful to society lack merit).

<sup>69</sup> Jones, *supra* note 59, at 921; *see* Hutter, *supra* note 58, at 318 (discussing the English courts’ “balancing of interests standard” and its adoption and articulation by the American courts “as a standard of ‘reasonableness’” (citations omitted)).

<sup>70</sup> Hutter, *supra* note 58, at 318–19 (citing *Gulick v. A. Robert Strawn & Assocs.*, 477 P.2d 489, 492 (Colo. Ct. App. 1970); *Briggs v. Butler*, 45 N.E.2d 757, 761 (Ohio 1942)); *see* Long, *supra* note 64, at 1308 (discussing the two-part test used by courts to determine the enforceability of noncompetition agreements).

<sup>71</sup> *See* RESTATEMENT (SECOND) OF CONTRACTS § 188 (1981); Glick et al., *supra* note 66, at 371 (quoting KURT H. DECKER, COVENANTS NOT TO COMPETE 44 (1993) (“The ‘reasonableness of a covenant has typically been determined by whether (i) the restraint protects a legitimate interest of the employer, not greater than necessary to protect that interest, and reasonably related to the interest being protected; (ii) the restraint does not unreasonably prevent the employee from earning a livelihood; and (iii) the restraint is in accord with public policy.”)); Carroll R. Wetzel, *Employment Contracts and Noncompetition Agreements*, U. ILL. L.F. 61, 61–62 (1969) (citing RESTATEMENT (FIRST) OF CONTRACTS § 515 (1932)). *But see* Blake, *supra* note 58, at 686 (“[T]he recognized method of decision is that of balancing the employer’s claims to protection against the burden on the employee. Once the judgment is made, almost never does a court proceed to consider possible injury to society as a separate matter. This is not surprising, for the balancing process engaged in will almost always result in maximizing the social values as well as those of the parties.”).

<sup>72</sup> *See* Bishara, *supra* note 68, at 298 & n.42 (“The question is one of balancing, on one hand, the terms of a contract that is on its face a restraint on trade, and on the other hand, concerns about protecting an employer’s goodwill and investment in an employee’s human capital.”); Hutter, *supra* note 58, at 318 (citing *Columbia Ribbon & Carbon Mfg., Co. v. A-1-A Corp.*, 369 N.E.2d 4, 6 (N.Y. 1977)); Long, *supra* note 64, at 1305 (“Often, courts use a balancing test whereby the various policy considerations are weighed to determine the outcome best attuned to the interests of the employee, employer, and the general public.” (citations omitted)); Ronald R. Barrick, Note, *An Employer’s Competitive Restraints on Former Employees*, 17 DRAKE L. REV. 69, 71 (1967–68) (citations

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restraint on competition may be permitted, but only when and where it is necessary to protect the employer's legitimate interests and is not harmful to the public.<sup>73</sup>

Under the first prong of the reasonableness test, a court will examine whether the employer has "a real need for protection."<sup>74</sup> Accordingly, where an employee had access to the employer's trade secrets or confidential customer information, or where the employee built close, exclusive relationships with customers, courts often will find that an employer has a legitimate need for protection.<sup>75</sup> On the other hand, a bare desire to discourage an employee from changing jobs so as not to lose the employer's investment in training, or an attempt to prevent competition by an individual who has acquired general knowledge and skills at the employer's expense, generally is insufficient.<sup>76</sup>

Under the second prong of the reasonableness test, a court will determine whether the scope of the noncompetition agreement is broader than necessary—in terms of time, territory, and subject matter—to protect the employer's legitimate interests.<sup>77</sup> For example, an agreement is considered reasonable in terms of temporal scope for the useful life of the claimed trade secrets or for the amount of time necessary for the employer to train a new employee and acquaint him or her with the

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omitted) ("In short, the problem encountered is a three way balancing of the equities. The employer needs insurance against unfair competition which must not be obtained at the expense of the public who is entitled to the employees' industry and services nor at the expense of the employee who must be able to pursue his calling and earn a livelihood.").

<sup>73</sup> See Long, *supra* note 64, at 1308 ("If the agreement is unreasonable in its scope, geographic boundaries, or duration, . . . [and] these unreasonableness factors sufficiently outweigh the employer's protectable interests, the noncompete will be voided."); Gary P. Kreider, *Trends in the Enforcement of Restrictive Employment Contracts*, 35 U. CIN. L. REV. 16, 17 (1966) (citations omitted) ("American courts have upheld contracts restricting future employment so long as the limitations they imposed were reasonable and not injurious to the public."). For an empirical study of noncompetition clause cases and the importance of the individual reasonableness factors to the outcomes in litigation, see Whitmore, *supra* note 58.

<sup>74</sup> Hutter, *supra* note 58, at 319.

<sup>75</sup> *Id.* at 320–21; Long, *supra* note 64, at 1309–10; Grody, *supra* note 62, at 183–84; Blake, *supra* note 58, at 653; see also *id.* at 653–74 (discussing the types of customer relationships and confidential information that are protectable as legitimate employer interests).

<sup>76</sup> Hutter, *supra* note 58, at 320; Grody, *supra* note 62, at 185; Lester, *supra* note 58, at 57 (discussing "employer investments in training"); Blake *supra* note 58, at 651–53; Long, *supra* note 64, at 1310–12. *Contra* Stone, *supra* note 59, at 751 ("Recently, . . . courts have justified enforcing covenants [not to compete] on the ground that the employer paid for an employee's training to acquire skills and is thus entitled to prevent the employee from utilizing those skills on behalf of a competitor, even when there is no trade secret involved.").

<sup>77</sup> See Hutter, *supra* note 58, at 329. This prong of the reasonableness test deals with the employee's interest in "maintain[ing] his mobility in the labor market." See Grody, *supra* note 62, at 186.

customers.<sup>78</sup> As for geographic scope, a restraint must not extend beyond the area in which the employer does business or the employee contacted customers—i.e., “the area in which the employer could suffer economic harm from the employee’s activities.”<sup>79</sup> In the Internet Age, and in our increasingly global economy, however, courts will not necessarily strike down a noncompetition agreement for lack of a territorial restriction and will permit national and global restrictions in appropriate cases.<sup>80</sup> Finally, a noncompetition agreement may only restrain an employee from performing the same type of activities for a competitor that the employee performed for the employer, or from contacting parties who were customers of the employer during the employee’s tenure.<sup>81</sup>

While a noncompetition agreement’s effect on the public interest traditionally played a small role in the reasonableness test, the weight accorded to this factor has grown.<sup>82</sup> Today, courts will consider society’s interests in competition and in an employer’s ability to trust its employees,<sup>83</sup> as well as society’s need for a particular employee’s services.<sup>84</sup> Thus, should an agreement cause the removal of a productive

<sup>78</sup> See Blake, *supra* note 58, at 677–78; Hutter, *supra* note 58, at 332–35.

<sup>79</sup> Hutter, *supra* note 58, at 329–32; see Lester, *supra* note 58, at 56–57 (citations omitted) (“As for geography, courts focus on whether the restraint exceeds the geographic area or territory in which the employee formerly worked, or where the employer conducted its business.”).

<sup>80</sup> See Hutter, *supra* note 58, at 329–31 (discussing how the “old view that any territorial restraint covering an entire state or the nation is *per se* unreasonable is no longer valid”); Stone, *supra* note 59, at 741 (“What a court considers to be reasonable duration and geographic scope varies from state to state and case to case. . . . Recently, some courts have upheld covenants that are wider in geographic scope than those they would have affirmed in the past on the grounds that the firm seeking to enforce the covenant competes in a nationwide or worldwide market.”); LORD, *supra* note 58, § 13:5 (stating that a covenant not to compete that is not limited as to geographic scope or that restrains competition within the entire country is not necessarily invalid *per se* as long as it is limited as to time and is reasonable overall).

<sup>81</sup> See Hutter, *supra* note 58, at 335 (discussing appropriate activity restrictions in noncompetition agreements); Lester, *supra* note 58, at 57 (citations omitted) (“Some restraints are invalidated because they restrict an unreasonably broad range of vocational activities, although more tailored restraints that simply prevent the employee from dealing with former customers may be deemed reasonable.”).

<sup>82</sup> See Glick et al., *supra* note 66, at 372–73 (“In early American common law, the [public interest] factor was not dispositive, merely tipping the scales in favor of either the employer or employee. However, in modern American common law, this factor may be dispositive if the restriction may harm the public.”).

<sup>83</sup> Grody, *supra* note 62, at 187–88.

<sup>84</sup> See RESTATEMENT (SECOND) OF CONTRACTS § 188 cmt. c (1981); Grody, *supra* note 62, at 187–88 (stating that the public interest favors “maintenance of adequate supplies of services[] and full use of labor resources”).

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and necessary employee from society, the injury to the public may be too great.<sup>85</sup>

The validity of noncompetition agreements and the ability to enter into such covenants in the United States are governed at the state level by the common law standards articulated above<sup>86</sup> or by statute, depending upon the jurisdiction.<sup>87</sup> Even in most of those states with statutes,

<sup>85</sup> See RESTATEMENT (SECOND) OF CONTRACTS § 188 cmt. c (1981) (“[T]he likely injury to the public may be too great if it is seriously harmed by the impairment of [the employee’s] economic mobility or by the unavailability of the skills developed in his employment.”). *But see* Kreider, *supra* note 73, at 19 (“In actuality, all restraints are bound to have a harmful effect on the public, since by limiting the mobility and supply of labor and the spread of business skills and information, they interfere with operation of the competitive economy . . . . Therefore, to present a problem to the enforceability of an employment contract which was otherwise valid, it would appear that some special injury to the public would have to be present.”).

<sup>86</sup> State and federal antitrust laws also may be relevant, as are general principles of contract law. *See* Wetzel, *supra* note 71, at 62 (citations omitted) (“[O]ccasionally [state antitrust] statutes have been construed to prohibit even incidental noncompetition agreements where their inhibitive effect upon competition has been significant.”); *id.* at 67 (citations omitted) (“If . . . the noncompetition agreement is only one weapon in an arsenal of devices to restrain trade or foster monopoly, the [federal] antitrust laws are violated.”); Glick et al., *supra* note 66, at 370, 408–17 (noting that noncompetition agreements may be subject to the Sherman Act); Grody, *supra* note 62, at 190 (“Contract law provides the legal foundation for enforcement [of covenants not to compete]. Its message is that the covenant should be enforced if the employee’s promise is supported by legally sufficient consideration.”).

<sup>87</sup> Nineteen states have enacted statutes governing the general use of post-employment covenants not to compete. *See* ALA. CODE § 8-1-1 (2012); CAL. BUS. & PROF. CODE §§ 16600–16602.5 (West 2012); COLO. REV. STAT. ANN. § 8-2-113 (West 2012); FLA. STAT. ANN. §§ 542.33–542.335 (West 2012); GA. CODE ANN. §§ 13-8-50 to 13-8-59 (West 2011); HAW. REV. STAT. § 480-4(c) (West 2011); IDAHO CODE ANN. §§ 44-2701 to 44-2704 (West 2012); LA. REV. STAT. ANN. § 23:921 (2011); MICH. COMP. LAWS ANN. § 445.774a (West 2012); MO. ANN. STAT. § 431.202 (West 2011); MONT. CODE ANN. §§ 28-2-703 to 28-2-705 (West 2011); NEV. REV. STAT. ANN. § 613.200(4) (West 2010); N.C. GEN. STAT. ANN. § 75-4 (West 2011); N.D. CENT. CODE ANN. § 9-08-06 (West 2011); OKLA. STAT. ANN. tit. 15, § 219A (West 2011); OR. REV. STAT. ANN. § 653.295 (West 2012); S.D. CODIFIED LAWS § 53-9-11 (West 2011); TEX. BUS. & COM. CODE ANN. §§ 15.50–15.52 (West 2011); WIS. STAT. ANN. § 103.465 (West 2012). The other states and the District of Columbia rely solely on common law. *See generally, e.g., Data Mgmt., Inc. v. Greene*, 757 P.2d 62 (Alaska 1988); *Bryceland v. Northey*, 772 P.2d 36 (Ariz. Ct. App. 1989); *Girard v. Rebsamen Ins. Co.*, 685 S.W.2d 526 (Ark. Ct. App. 1985); *New Haven Tobacco Co. v. Perrelli*, 528 A.2d 865 (Conn. App. Ct. 1987); *McCann Surveyors, Inc. v. Evans*, 611 A.2d 1 (Del. Ch. 1987); *Ellis v. James v. Hurson Assocs., Inc.*, 565 A.2d 615 (D.C. 1989); *Lawrence & Allen, Inc. v. Cambridge Human Res. Grp., Inc.*, 685 N.E.2d 434 (Ill. App. Ct. 1997); *Commercial Bankers Life Ins. Co. of Am. v. Smith*, 516 N.E.2d 110 (Ind. Ct. App. 1987); *Baker v. Starkey*, 144 N.W.2d 889 (Iowa 1966); *Weber v. Tillman*, 913 P.2d 84 (Kan. 1996); *Hammons v. Big Sandy Claims Serv., Inc.*, 567 S.W.2d 313 (Ky. Ct. App. 1978); *Chapman & Drake v. Harrington*, 545 A.2d 645 (Me. 1988); *Becker v. Bailey*, 299 A.2d 835 (Md. 1973); *Novelty Bias Binding Co. v. Shevrin*, 175 N.E.2d 374 (Mass. 1961); *Bennett v. Storz Broad. Co.*, 134 N.W.2d 892 (Minn. 1965); *Empiregas, Inc. of Kosciusko v. Bain*, 599 So. 2d 971 (Miss. 1992); *Philip G. Johnson & Co. v. Salmen*, 317 N.W.2d 900 (Neb. 1982); *Smith, Batchelder & Rugg v. Foster*, 406 A.2d 1310 (N.H. 1979); *Solari Indus., Inc. v. Malady*, 264 A.2d 53 (N.J. 1970); *Lovelace Clinic v. Murphy*, 417 P.2d 450 (N.M. 1966); *Am. Broad. Cos. v. Wolf*, 52 N.Y.2d 394 (N.Y. 1981); *Premier Assocs., Ltd. v. Loper*, 778 N.E.2d 630 (Ohio Ct. App. 2002); *Boldt Mach. & Tools, Inc. v. Wallace*, 366 A.2d 902 (Pa. 1976); *Max Garelick, Inc. v.*

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however, the reasonableness of the covenant is still a concern.<sup>88</sup> Only two states—California and North Dakota—ignore the reasonableness test and forbid the use of employee noncompetition agreements altogether.<sup>89</sup> These state laws control in diversity of citizenship cases in federal court, as well.<sup>90</sup>

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*Leonardo*, 250 A.2d 354 (R.I. 1969); *Oxman v. Profitt*, 126 S.E.2d 852 (S.C. 1962); *Allright Auto Parks, Inc. v. Berry*, 409 S.W.2d 361 (Tenn. 1966); *Sys. Concepts, Inc. v. Dixon*, 669 P.2d 421 (Utah 1983); *Vt. Elec. Supply Co. v. Andrus*, 315 A.2d 456 (Vt. 1974); *Roanoke Eng'g Sales Co. v. Rosenbaum*, 290 S.E.2d 882 (Va. 1982); *Perry v. Moran*, 748 P.2d 224 (Wash. 1987); *Voorhees v. Guyan Mach. Co.*, 446 S.E.2d 672 (W. Va. 1994); *Hopper v. All Pet Animal Clinic, Inc.*, 861 P.2d 531 (Wyo. 1993). For a comprehensive review of the relevant state laws, see BRIAN M. MALSBERGER, COVENANTS NOT TO COMPETE: A STATE-BY-STATE SURVEY (Robert A. Blackstone & Arnold H. Pedowitz et al. eds., 5th ed. 2006 & Supp. 2007).

<sup>88</sup> See generally, e.g., *Orkin Exterminating Co., Inc. v. Etheridge*, 582 So. 2d 1102 (Ala. 1991); *Miller v. Kendall*, 541 P.2d 126 (Colo. App. 1975); FLA. STAT. ANN. § 542.335; GA. CODE ANN. §§ 13-8-53, 13-8-56, 13-8-57 (West 2013); *Technicolor, Inc. v. Traeger*, 551 P.2d 163 (Haw. 1976); IDAHO CODE ANN. §§ 44-2701–44-2704 (West 2013); MICH. COMP. LAWS ANN. § 445.774(a) (West 2013); MO. ANN. STAT. § 431.202 (West 2013); *State Med. Oxygen & Supply, Inc. v. Am. Med. Oxygen Co.*, 782 P.2d 1272 (Mont. 1989); NEV. REV. STAT. ANN. § 613.200(4) (West 2013); *Manpower of Guilford Cnty., Inc. v. Hedgecock*, 257 S.E.2d 109 (N.C. Ct. App. 1979); *Cohen Realty, Inc. v. Marinick*, 817 P.2d 747 (Okla. Civ. App. 1991); TEX. BUS. & COM. CODE ANN. §§ 15.50–15.52 (West 2013); *Fields Found., Ltd. v. Christensen*, 309 N.W.2d 125 (Wis. Ct. App. 1981).

<sup>89</sup> See CAL. BUS. & PROF. CODE §§ 16600, *et seq* (West 2013). (“Except [as used in conjunction with the sale of a business or interest in a business], every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void.”); N.D. CENT. CODE ANN. § 9-08-06 (“Every contract by which anyone is restrained from exercising a lawful profession, trade, or business of any kind is to that extent void, except: [as used in conjunction with the sale of a business or in the dissolution of a partnership].”). Two states, Hawaii and Oklahoma, allow noncompetition agreements to the extent they only prevent the disclosure of trade secrets or the direct solicitation of the former employer’s customers, respectively. See HAW. REV. STAT. § 480-4(c) (West 2013) (“[I]t shall be lawful for a person to enter into any of the following restrictive covenants or agreements ancillary to a legitimate purpose not violative of this chapter, unless the effect thereof may be substantially to lessen competition or to tend to create a monopoly in any line of commerce in any section of the State: . . . covenant or agreement by an employee or agent *not to use the trade secrets of the employer or principal in competition with the employee’s or agent’s employer or principal*, during the term of the agency or thereafter, or after the termination of employment, within such time as may be reasonably necessary for the protection of the employer or principal, without imposing undue hardship on the employee or agent.”) (emphasis added); OKLA. STAT. ANN. tit. 15, § 219A (West 2013) (“A person who makes an agreement with an employer, whether in writing or verbally, not to compete with the employer after the employment relationship has been terminated, shall be permitted to engage in the same business as that conducted by the former employer or in a similar business as that conducted by the former employer *as long as the former employee does not directly solicit* the sale of goods, services or a combination of goods and services from the established customers of the former employer. . . . Any provision in a contract between an employer and an employee in conflict with the provisions of this section shall be void and unenforceable.”) (emphasis added).

<sup>90</sup> Marshall H. Tanick & Phillip J. Trobaugh, *Noncompetes for Professionals: It’s Not for Amateurs*, BENCH & BAR OF MINN. 22, 22 (March 2012) (“The federal courts, when confronted with noncompete clauses in diversity of citizenship cases under 28 U.S.C. § 1332, follow applicable state law under the *Erie* doctrine.”).

### III. FEDERAL LAW SHOULD RENDER UNENFORCEABLE NONCOMPETITION AGREEMENTS PREVENTING EMPLOYEE MOBILITY BETWEEN CHARITABLE NONPROFITS

As discussed above, the law governing noncompetition agreements has slowly evolved to deal with modern society's increasingly global and mobile marketplace. In turn, academics have suggested additional reformation to ensure the law truly keeps pace with reality. For example, one scholar, Norman D. Bishara, has advocated for enforcement of noncompetition agreements based on the public policy implications of the nature of the employee's status as either a "creative" or "service" employee.<sup>91</sup> Professor Bishara argued that covenants not to compete should not be enforced against "creative" workers, who develop products, because innovation should be encouraged.<sup>92</sup> But, he argued, covenants not to compete should be enforced against "service" workers, who use their skills and the developed products to render services, because a company's interest in confidentiality and client development should be respected.<sup>93</sup> However, rather than enforcing—or refusing to enforce—noncompetition agreements based on the nature of the employee or based solely on the public policy concerns discussed earlier,<sup>94</sup> this Article proposes a distinction based on the nature of *the employer*: To the extent noncompetition agreements are used to prevent an employee of one charitable nonprofit from leaving and working for another charitable nonprofit, the agreements should be considered unenforceable. A federal mandate is necessary to effectively implement this rule on a national scale.

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<sup>91</sup> See Bishara, *supra* note 68, at 293 (“[T]here are consistent, common implications for categorizing workers in an information economy as ‘service’ or ‘creative’ employees for [covenants not to compete] . . . [and] within the service and creative job categories, [covenants not to compete] can be selectively enforced to create positive spillovers and maximize useful knowledge transfers.”).

<sup>92</sup> *Id.* at 313, 321. One example of a “creative” employee is a chemist who researches new drugs. *Id.* at 313.

<sup>93</sup> *Id.* at 313–14, 320–21. Examples of a “service” employee are the pharmaceutical salesperson who sells drugs and the pharmacist who prescribes the drugs. See *id.* at 313–14.

<sup>94</sup> See *supra* notes 65–68 and accompanying text. The public interest is an important factor and, in the context of a charitable nonprofit organization, there is an argument that this factor alone should be sufficient to invalidate the use of noncompetition agreements. However, this Article focuses on the inappropriateness of noncompetition agreements based on the characteristics of the charitable nonprofit organization.

A. THE PROBLEM: NONCOMPETITION AGREEMENTS ARE  
INAPPROPRIATE AND UNNECESSARY FOR USE BETWEEN  
CHARITABLE NONPROFITS

It is inappropriate and unnecessary for a charitable nonprofit to prevent an employee from leaving to work for another charitable nonprofit for two main reasons. First, noncompetition agreements are contrary to charitable nonprofits' missions of furthering society's best interests, and use of such agreements contravenes the reasons for granting those organizations tax-exempt status in the first place. Moreover, as a result of their missions and tax-exempt status, charitable nonprofits do not engage in "traditional" competition and, therefore, should not be allowed to use traditional profit-maximizing tools to their advantage. Second, there exist equally effective, alternative methods of protecting a charitable nonprofit's legitimate business interests.

1. *Noncompetition agreements are contrary to the mission and tax-exempt status of the charitable nonprofit organization*

While the use of noncompetition agreements to prevent employee mobility often is aligned with the for-profit mission of increasing revenue and rewarding shareholders, use of those agreements is directly contrary to the charitable nonprofit's mission of bettering society.<sup>95</sup> Recall the mission statements of the charitable nonprofits listed above, through which the organizations pledged, among other things, to "provide relief to victims of disaster," "to contribute to health and well-

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<sup>95</sup> See Eleanor D. Kinney, Symposium Introduction, *Hospital-Physician Joint Ventures: A Promising Partnership?*, 4 IND. HEALTH L. REV. 205, 207 (2007) (discussing an observation made by Steve Pratt, a law firm partner, that a community-based hospital's use of noncompetition agreements with its physicians "is somewhat inconsistent with the theory that underlies the nonprofit community-based hospitals—to serve the community."). One recent case dealt with a similar argument. In *Healthcare Services of the Ozarks, Inc. v. Copeland*, two individuals had signed noncompetition agreements with their former employer, a not-for-profit corporation. 198 S.W.3d 604, 607, 614 (Mo. 2006). In the agreements, the individuals promised not to engage in a competitive business within a 100-mile radius for a period of two years following the end of their employment. See *id.* at 607–08. Within days of leaving their employment, the individuals accepted jobs at a competing for-profit business. See *id.* at 608. The former employees argued that "the noncompete agreements [we]re not enforceable as a matter of public policy because [the former employer] [wa]s a not-for-profit corporation and [w]as not entitled to 'restrain trade in the conduct of charitable activities.'" *Id.* at 614. The Missouri Supreme Court rejected this argument on the grounds that nonprofit and for-profit entities have the same corporate powers and equally-protectable business interests, stating that the only difference was what the entities did with their earnings. See *id.* Contrary to the argument in this Article, however, the Missouri Supreme Court's holding in that case dealt only with a nonprofit's right to use noncompetition agreements to protect itself from unfair competition by *for-profit* competitors.

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being,” and “to provide service to people in need.”<sup>96</sup> Society is the ultimate benefactor of those organizations’ services. Now consider, for example, an individual whose employment at such an entity has ended due to organizational restructuring, but who is prevented by virtue of a noncompetition agreement from utilizing his or her expertise and joining the staff of a similar charitable organization.<sup>97</sup> In that situation—and in countless other loss-of-employment situations—the result is a net loss to society.

Not only might enforcement of a noncompetition agreement in such situations cause an outcome that conflicts with the charitable nonprofits’ purposes, but the action of requiring an individual to sign a noncompetition agreement itself might cause the same conflict with the charitable nonprofits’ purposes. Knowing that a noncompetition agreement will limit the options available to an employee upon leaving the employer (and, therefore, that it will effectively limit the employee’s ability to quit), an individual may decide not to join an organization where his or her skills and compassion would be utilized to serve society in the first place, if signing a noncompetition agreement is a requirement of employment.<sup>98</sup> Again, this results in a net loss to society and is directly contrary to the typical charitable nonprofit’s mission.

Because the altruistic mission is intrinsically tied to the charitable nonprofit’s characterization as a § 501(c)(3) organization, the use of noncompetition agreements also is in direct conflict with the charitable nonprofit’s tax-exempt status. As discussed above, in order to qualify as a § 501(c)(3) organization, an entity must be “organized and operated exclusively” for a charitable purpose. As noted by two prominent scholars, “there are important differences in how most nonprofits function as compared with for-profit activities. The difference lies in . . . the reasons why a service is offered—to benefit the individual and the community, not to make a profit.”<sup>99</sup> Thus, employing a business tactic

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<sup>96</sup> See *supra* notes 21–25 and accompanying text.

<sup>97</sup> This example is not based on specific, real-life events, and the author has no information as to whether the organizations whose mission statements are referenced herein utilize noncompetition agreements.

<sup>98</sup> See Bishara, *supra* note 68, at 289 (“While there is little empirical research on the use of noncompetes, there are indications that such agreements are increasingly common and as a result this sort of post-employment restriction will influence the decisions of employers and employees.”); Cynthia L. Estlund, *Between Rights and Contract: Arbitration Agreements and Non-Compete Covenants as a Hybrid Form of Employment Law*, 155 U. PA. L. REV. 379, 407 (2006–2007) (“But perhaps the most troubling effect of non-compete covenants is that, by limiting what the employee can do after leaving the job, they also burden the ability to quit, and with it the ability to demand better wages and working conditions and to resist oppressive conditions in the current job.”).

<sup>99</sup> WELLFORD & GALLAGHER, *supra* note 1, at ix–x.



that places the organization's financial interests above society's interests should raise a red flag for the Internal Revenue Service.<sup>100</sup>

Moreover, per their § 501(c)(3) status, charitable nonprofits already receive advantages that for-profit entities—and even other categories of nonprofit entities—do not, such as exemptions from federal income tax and their donors' ability to deduct charitable contributions.<sup>101</sup> As discussed above, these allowances cause charitable nonprofits to engage in a different type of competition depending upon the type of competitor they face. Charitable nonprofits engage in traditional competition (i.e., for customers) with their for-profit counterparts, but in non-traditional competition (i.e., for donors, grants, *and* customers) with other charitable nonprofits. Thus, because charitable organizations are engaged in non-traditional competition with each other, they should not be allowed to use noncompetition agreements—traditional, profit-maximizing tools of competition—to their advantage.<sup>102</sup>

<sup>100</sup> See Elizabeth A. Weeks, *The New Economic Credentialing: Protecting Hospitals from Competition by Medical Staff Members*, 36 J. HEALTH L. 247, 282–83 (2003); Hansmann, *Evolving Law*, *supra* note 5, at 827 (“In fiscal law, . . . and especially in the area of taxation, there is a good case for discriminating among different types of nonprofits according to the functions they serve, and in particular for being more discriminating than in the past by granting exemption only to organizations that are truly charitable.”); Hansmann, *Evolving Law*, *supra* note 5, at 822 (“[T]here is a good argument for removing the exemption from commercial nonprofits that are anachronistic or opportunistic.”). *But see Wexford Med. Grp. v. City of Cadillac*, 713 N.W.2d 734, 748 (Mich. 2006) (finding that an entity's use of noncompetition agreements was not sufficient to cause it to lose its charitable status). For example, “[a] nonprofit hospital's decision to adopt a policy to restrict or eliminate competition by medical staff members may affect the hospital's status as a charitable organization.” Weeks, *supra*, at 282. Employing such policies “has the appearance of placing the financial bottom-line of the hospital—and, accordingly, the benefit of hospital administrators and shareholders—above charitable purposes,” and could “cause the IRS to question whether the hospital is organized and operated exclusively for charitable purposes.” *Id.* at 283; see Kinney, *supra* note 94, at 207 (“While [nonprofit community-based] hospitals have an obligation to remain financially healthy, tying up physicians with non-competes in a way that is good for the hospital but not good for the community is inconsistent with the theory of tax-exempt organizations.”).

<sup>101</sup> See *supra* notes 27–36 and accompanying text.

<sup>102</sup> While this Article does not propose that charitable nonprofits should be prohibited from using noncompetition agreements to prevent their employees from leaving to work for a for-profit competitor, an argument for such a proposition exists because the tax breaks charitable nonprofits receive per their § 501(c)(3) status already serve as a buffer against competition. See Tuckman, *supra* note 1, at 187 (stating that “[t]he subsidies that 501(c)(3) organizations receive offer some cushion against competition”); Rudnick, *supra* note 9, at 326 (“Tax exemptions give nonprofits a competitive advantage over for-profit organizations.”).

2014] *Charitable Nonprofits & Noncompetition Agreements* 3012. *Charitable nonprofits can use alternative means to protect their legitimate business interests*

This Article does not propose that charitable nonprofits should be left defenseless when it comes to protecting their trade secrets and confidential client information. Rather, it suggests that charitable nonprofits can effectively protect those interests by use of mechanisms that are less onerous than noncompetition agreements, including the law of unfair competition, confidentiality or nondisclosure agreements, nonsolicitation agreements, and incentive-based policies.<sup>103</sup> While, in some ways, these tools may not be as iron-clad or easy to enforce as noncompetition agreements,<sup>104</sup> they are better-suited to the nature of the charitable nonprofit and will adequately protect an organization's legitimate business interests.

First, an employer may protect its confidential information by invoking the law of unfair competition, which prohibits the misappropriation of trade secrets, against a former employee.<sup>105</sup> To establish a valid claim, an employer must show that the information it seeks to protect is a trade secret (i.e., that it is commercially valuable because it is not generally known or readily ascertainable to others, and that it is subject to reasonable efforts to maintain its secrecy) and that the former employee has improperly acquired, disclosed, or used the trade secret or has threatened to do so.<sup>106</sup> Relying on the law of unfair

<sup>103</sup> See Estlund, *supra* note 97, at 395 (describing nondisclosure and nonsolicitation agreements as "less restrictive alternatives" because they "do not tread on the employee's ability to work"). Other proposed alternatives include requiring employees to pay, through reduced wages, for access to the employer's trade secrets or monitoring use of confidential information such that no single employee has access to the entire trade secret. See Lester, *supra* note 58, at 51–52. Those less common methods will not be discussed in this Article.

<sup>104</sup> See, e.g., Hutter, *supra* note 58, at 314 ("[I]t can be easily seen that the use of employee non-competition agreements is the primary and most effective way to guard against unauthorized use of confidential business information by an ex-employee.").

<sup>105</sup> See, e.g., Hutter, *supra* note 58, at 314; Stone, *supra* note 59, at 738, 756–57.

<sup>106</sup> See UNIFORM TRADE SECRETS ACT §§ 1–2 (1985). These are the elements of a misappropriation of trade secrets claim under the Uniform Trade Secrets Act, a version of which has been adopted by forty-six states. See ALA. CODE §§ 8-27-1 to 8-27-6 (West 2012); ALASKA STAT. ANN. §§ 45.50.910–45.50.945 (West 2012); ARIZ. REV. STAT. ANN. §§ 44-401 to 44-407 (2012); ARK. CODE ANN. §§ 4-75-601 to 4-75-607 (West 2012); CAL. CIV. CODE §§ 3426–3426.11 (West 2012); COLO. REV. STAT. ANN. §§ 7-74-101 to 7-74-110 (West 2012); CONN. GEN. STAT. ANN. §§ 35-50 to 35-58 (West 2012); DEL. CODE ANN. tit. 6, §§ 2001–2009 (West 2012); FLA. STAT. ANN. §§ 688.001–688.009 (West 2012); GA. CODE ANN. §§ 10-1-760 to 10-1-767 (West 2011); HAW. REV. STAT. § 482B-1 to 482B-9 (West 2011); IDAHO CODE ANN. §§ 48-801 to 48-807 (West 2012); 765 ILL. COMP. STAT. ANN. 1065/1–1065/9 (West 2012); IND. CODE ANN. §§ 24-2-3-1 to 24-2-3-8 (West 2012); IOWA CODE ANN. §§ 550.1–550.8 (West 2012); KAN. STAT. ANN. §§ 60-3320 to 60-3330 (West 2011); KEN. REV. STAT. ANN. §§ 365.880–365.900 (West 2011); LA. REV. STAT. ANN.

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competition has its downsides: disclosure may seem unavoidable when the former employee is engaging in a similar occupation, and the necessary evidence of misconduct often is hard to come by.<sup>107</sup> However, the doctrine of inevitable disclosure allows courts to provide an injunction against competition even in the absence of actual misappropriation where an employer can demonstrate that a former employee “will necessarily disclose” a particular trade secret learned from the employer in the course of the new employment.<sup>108</sup> Thus, a cause of action for misappropriation of trade secrets provides a viable alternative to a noncompetition agreement.

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§§ 51:143–51:1439 (West 2011); ME. REV. STAT. ANN. tit. 10, §§ 1541–1548 (2011); MD. CODE ANN., COM. LAW §§ 11-1201 to 11-1209 (West 2012); MICH. COMP. LAWS ANN. §§ 445.1901–445.1910 (West 2012); MINN. STAT. ANN. §§ 325C.01–325C.08 (West 2012); MISS. CODE ANN. §§ 75-26-1 to 75-26-19 (West 2011); MO. ANN. STAT. §§ 417.450–417.467 (West 2012); MONT. CODE ANN. §§ 30-14-401 to 30-14-409 (West 2011); NEB. REV. STAT. ANN. §§ 87-501 to 87-507 (West 2011); NEV. REV. STAT. ANN. §§ 600A.010–600A.100 (West 2011); N.H. REV. STAT. ANN. §§ 350-B:1 to 350-B:9 (2012); N.M. STAT. ANN. §§ 57-3A-1 to 57-3A-7 (West 2012); N.D. CENT. CODE ANN. §§ 45-25.1-01 to 45-25.1-08 (West 2011); N.J. STAT. ANN. §§ 56:15-1 to 56:15-9 (West 2012); OHIO REV. CODE ANN. §§ 1333.61–1333.69 (West 2011); OKLA. STAT. ANN. tit. 78, §§ 85–95 (West 2012); OR. REV. STAT. ANN. §§ 646.461–646.475 (West 2012); 12 PA. CONS. STAT. ANN. §§ 5301–5308 (West 2012); R.I. GEN. LAWS ANN. §§ 6-41-1 to 6-41-11 (West 2012); S.C. CODE ANN. §§ 39-8-20 to 39-8-130 (West 2011); S.D. CODIFIED LAWS §§ 37-29-1 to 37-29-11 (West 2011); TENN. CODE ANN. §§ 47-25-1701 to 47-25-1709 (West 2012); UTAH CODE ANN. §§ 13-24-1 to 13-24-9 (West 2011); VT. STAT. ANN. tit. 9, §§ 4601–4609 (West 2012); VA. CODE ANN. §§ 59.1-336 to 59.1-343 (West 2011); WASH. REV. CODE ANN. §§ 19.108.010–19.108.940 (West 2012); W. VA. CODE ANN. §§ 47-22-1 to 47-22-10 (West 2012); WIS. STAT. ANN. § 134.90 (West 2011); WYO. STAT. ANN. §§ 40-24-101 to 40-24-110 (West 2012). The elements are similar at common law. *See* Hutter, *supra* note 58, at 314 (citing 1 R. MILGRAM, TRADE SECRETS § 3.02 (1979) (“[T]he courts are in general agreement that liability [for trade secret misappropriation] requires proof of two essential elements: that the information qualifies as a trade secret and that the ex-employee is using or threatens to use the trade secret to the ex-employer’s detriment.”)).

<sup>107</sup> *See* Hutter, *supra* note 58, at 314–15 (discussing the pitfalls of relying on a misappropriation of trade secrets claim for protection, including the burden of demonstrating that use or disclosure has occurred or is imminent); *see also id.* at 317 (“To be sure, the employer must establish the ‘reasonableness’ of the non-competition agreement, but this burden is usually less difficult than the burden of establishing actual or imminent use.”) (citations omitted); Grody, *supra* note 62, at 184 (“The law of unfair competition might afford some protection . . . . A written agreement, however, gives the employer access to a more favorable body of law and is likely to entitle him to somewhat broader relief than may otherwise be obtainable.”). Another concern is that, “even if the employer discovers misappropriation and pursues legal redress, additional leaks of the confidential information [could occur] in the course of legal proceedings.” Lester, *supra* note 58, at 53.

<sup>108</sup> *See* Eleanore R. Godfrey, *Inevitable Disclosure of Trade Secrets: Employee Mobility v. Employer’s Rights*, 3 J. HIGH TECH. L. 161, 166, 168 (2004). “[T]he doctrine prohibits employees from using or disclosing any trade secrets of a former employer, [but] does not prevent employees from using any skills or general knowledge that they acquired through their work experience.” *Id.* at 166–67. Not all jurisdictions recognize this doctrine, and others require a showing of bad faith on the part of the former employee or irreparable harm to the employer in addition to a demonstration of inevitable disclosure. *Id.* at 173, 176–77.

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Second, instead of limiting where and for whom an individual can work, an employer can limit the information the individual can use in his or her future employment through a confidentiality or nondisclosure agreement.<sup>109</sup> These agreements typically prevent former employees from using or disclosing to a competitor specific, confidential information obtained during their employment.<sup>110</sup> While there are several problems with nondisclosure agreements (e.g., they may be somewhat difficult to enforce because an employer will not be able to monitor its former employees' communications with a new employer,<sup>111</sup> it may be difficult to specify with particularity at the outset of employment the information that should be deemed confidential,<sup>112</sup> and the employer would rather prevent the disclosure from occurring altogether rather than simply have a remedy for it after-the-fact<sup>113</sup>), these agreements are preferable to noncompetition agreements because they are more narrowly-tailored to the employer's legitimate business interests. Furthermore, enforcing nondisclosure agreements is more efficient for employers than seeking recourse through unfair competition law because the information at issue need not satisfy the legal definition of a trade secret,<sup>114</sup> and these agreements are longer-lasting than

<sup>109</sup> See Hutter, *supra* note 58, at 315–16; Stone, *supra* note 59, at 738. In addition, “the nature of the employment relationship [generally] imposes an implied duty on agents and employees to protect the employer’s trade secrets and other confidential information, which has often been held to survive the termination of the employment relationship.” LORD, *supra* note 58, §§ 54:31–54:32 (citations omitted). Of course, the better practice is to express the duty in writing in a confidentiality agreement.

<sup>110</sup> Hutter, *supra* note 58, at 315–16; Blake, *supra* note 58, at 669; Stone, *supra* note 59, at 738; BLACK’S LAW DICTIONARY 1079 (8th ed. 2004) (defining “nondisclosure agreement” as “[a] contract or contractual provision containing a person’s promise not to disclose any information shared by or discovered from a trade-secret holder, including all information about trade secrets, procedures, or other internal matters.”).

<sup>111</sup> See Wetzel, *supra* note 71, at 65–66 (citations omitted) (“If an employee has been in a position to learn his employer’s trade secrets, a covenant not to compete provides greater assurance that such secrets will not be disclosed than does a mere covenant not to disclose, which may be difficult to enforce.”); Blake, *supra* note 58, at 690 (stating that “that there [may] be no practical way to police whether or not a former employee is violating the covenant”).

<sup>112</sup> Blake, *supra* note 58, at 669.

<sup>113</sup> *Id.* (“[T]he important thing to the employer is not having a cause of action in case of a breach of confidence, but preventing the violation from occurring. An injunction not to disclose can seldom undo or effectively prevent the doing of the real damage.”).

<sup>114</sup> See Barrick, *supra* note 72, at 77 (quoting R. MILGRIM, TRADE SECRETS § 3.02(1)(d) (1967) (“Since it is infrequently difficult to determine whether a certain class of information qualifies as a trade secret, it appears desirable to protect by contract classes of information and data that, individually or collectively, might constitute a trade secret. A court need not determine that such information or data is a trade secret, but rather only that the covenant to protect it was reasonable.”)).

noncompetition agreements because they typically are enforceable as long as the information remains confidential.<sup>115</sup>

Third, an employer can use a nonsolicitation agreement to protect its customer relations. This type of agreement is a covenant by an individual to not solicit his or her former employer's clientele after termination of employment.<sup>116</sup> In the case of the charitable nonprofit, the key "clients" are the donors; the individuals who actually utilize the organization's services are not as likely to follow a departed employee because they may be utilizing the organization's services out of necessity rather than loyalty to a particular employee. While an employer risks souring its existing client relationships by enforcing nonsolicitation agreements,<sup>117</sup> these agreements—like nondisclosure agreements—are much more narrowly-tailored to the employer's legitimate business interests and are less onerous than noncompetition agreements.<sup>118</sup>

Finally, rather than requiring an employee to sign an agreement that prohibits certain behavior upon termination, an employer can provide the employee with incentives to remain with the organization (i.e., offer a carrot rather than wield a stick). In this vein, charitable nonprofits could offer a form of tenure to those employees who have become deeply involved with the company such that they have access to its confidential information or have formed meaningful relationships with donors.<sup>119</sup> Tenure confers a permanent or secure status on an employee by allowing for termination only in rare or extenuating circumstances, such as financial exigency, professional incompetence, illegal activity, or sexual harassment.<sup>120</sup> While tenure sometimes is criticized for removing

<sup>115</sup> See Blake, *supra* note 58, at 689–90; see also LORD, *supra* note 58, § 54:33.

<sup>116</sup> See Blake, *supra* note 58, at 653–54, 690; BLACK'S LAW DICTIONARY 1084 (8th ed. 2004) (defining "nonsolicitation agreement" as "[a] promise, [usually] in . . . an employment contract to refrain, for a specified time, from either (1) enticing employees to leave the company or (2) trying to lure customers away"). Professor Blake describes nonsolicitation agreements as "a narrow form" of noncompetition agreements. Blake, *supra* note 58, at 657 n.89.

<sup>117</sup> Blake, *supra* note 58, at 657 ("[T]he former employer is not likely to maintain happy relations with a customer who learns that a court order has been obtained which prevents him from receiving an offer from an old business friend.").

<sup>118</sup> See Estlund, *supra* note 98, at 425 (stating that nonsolicitation agreements "impose lower costs on the employee and the public" than noncompetition agreements).

<sup>119</sup> Another type of incentive is the use of "golden handcuffs," which means the employer pays an employee to continue working at the organization. Lester, *supra* note 58, at 51–52. However, "it would be necessary to pay the employee enough to make him indifferent between exploiting the information elsewhere and staying," which may be exorbitant. *Id.* at 52. Moreover, golden handcuffs often come in the form of stock options, see *id.*, which charitable nonprofits do not use.

<sup>120</sup> See BLACK'S LAW DICTIONARY 1509 (8th ed. 2004) (defining "tenure" as "the legal protection of a long-term relationship, such as employment" and as "[a] status afforded to a teacher or professor as a protection against summary dismissal without sufficient cause"); see also *id.*

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incentives for productivity,<sup>121</sup> it rewards employee loyalty and also results in a more stable workforce for the employer—in other words, both parties benefit.<sup>122</sup> As an added bonus, utilization of a tenure system may entice employees who are deciding between a for-profit entity and its charitable nonprofit counterpart to choose the latter.<sup>123</sup>

Many institutions in the education sector, which makes up a large subsection of the charitable nonprofit sector,<sup>124</sup> award tenure to faculty

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(defining “tenured faculty” as “[t]he members of a school’s teaching staff who hold their positions for life or until retirement, and who may not be discharged except for cause”); See Mark L. Adams, *The Quest for Tenure: Job Security and Academic Freedom*, 56 CATH. U. L. REV. 67, 74–75 (2006); James J. Fishman, *Tenure and Its Discontents: The Worst Form of Employment Relationship Save All of the Others*, 21 PACE L. REV. 159, 200 (2000).

<sup>121</sup> See Adams, *supra* note 120, at 71; see also Fishman, *supra* note 120, at 170–72 (discussing several criticisms of tenure).

<sup>122</sup> See Adams, *supra* note 120, at 91 (discussing how tenure contributes to stability in the university context); Fishman, *supra* note 120, at 179–80 (discussing the benefits of academic tenure).

<sup>123</sup> See Adams, *supra* note 120, at 70 (“Tenure provides an important protection through the benefit of job security that offsets the salary differences between those who choose an academic, as opposed to a professional or business, career.”); Fishman, *supra* note 120, at 181–82 (“Colleges and universities historically have not had the financial resources to pay faculty at rates competitive with private industry or the marketplace. In real terms, professorial and public service salaries have risen little in the post-war period, while the incomes of professionals and business people have shown large gains. One way to overcome the economic inequalities is through non-salaried benefits such as tenure.”); Robert W. McGee and Walter E. Block, *Academic Tenure: An Economic Critique*, 14 HARV. J.L. & PUB. POL’Y 545, 546–47 (1991) (“Because most people are risk-averse, they would choose the position that included a guaranteed job for life, other things being equal. Therefore, the possession of tenure has some value. That being the case, professors who have tenure, or who are hired with the possibility of receiving tenure, will work for less money than professors who cannot hope to receive a guarantee of lifetime employment.”).

<sup>124</sup> Two dominant subsections of the charitable nonprofit sector are healthcare and education. See Boris & Steuerle, *supra* note 3, at 72–80 (discussing the statistics related to reporting public charities and demonstrating that higher education and hospitals are dominant in terms of finances and employment); Leete, *supra* note 30, at 160, 160 tbl.7.2 (“In 2001, 41.9 percent of nonprofit employment was devoted to health services, 21.9 percent to education or research organizations, 11.8 percent to religious organizations (including congregations), 18.3 percent to legal and social services, with the remainder in foundations, arts and culture, and civic, fraternal, and social organizations.”); *SOI Tax Stats - Charities & Other Tax-Exempt Organizations*, INTERNAL REVENUE SERVICE, [www.irs.gov/pub/irs-soi/07eocharitiessnap.pdf](http://www.irs.gov/pub/irs-soi/07eocharitiessnap.pdf) (last visited May 1, 2014) [hereinafter *Statistics of Income*] (stating that, for the 2007 tax year, “large hospitals and universities dominated the financial activity of the nonprofit charitable sector”). In 2000, charitable nonprofits in the healthcare industry had revenues of approximately \$450.7 billion, while those in the education industry earned \$166.2 billion. Boris & Steuerle, *supra* note 3, at fig.3.6 (citing The Urban Institute, NCCS/GuideStar National Nonprofit Database (2000)). In 2004, nonprofit health services organizations accounted for 59% of total nonprofit spending, while nonprofit educational entities accounted for 17%. Hines Jr. et al., *supra* note 1, at 1185 (citing Paul Arnsberger, *Charities, Social Welfare, and Other Tax-exempt Organizations*, 2004, STAT. INCOME BULL., Fall 2007, at 210, 213). In 2008, “nine of the ten largest organizations (measured by assets) were hospitals or university-affiliated organizations.” *Statistics of Income*, *supra*. During that tax year, health-related organizations ranked first in the charitable nonprofit sector in terms of revenue, with a reported

members who have contributed to the school positively through scholarship, teaching, and service.<sup>125</sup> This system, in part, allows the universities to protect their investment in their employees as well as their relationships with donors. To illustrate, consider this cycle of activity: Universities invest money into their faculty members' research and scholarship, through which the faculty members come to be known as experts in their particular field and the university gains recognition. When the university gains recognition, it is likely to draw more donor support, and many faculty members form relationships with the donors. Accordingly, the tenure system allows universities to retain employees who—if they were to leave—might take with them not only their reputation, but possibly also some donors. A similar system could work effectively in other charitable nonprofit organizations, as well.<sup>126</sup> Thus, several equally—and in some instances, more—effective alternatives to the traditional noncompetition agreement exist.

B. THE PROPOSAL: CONGRESS SHOULD RENDER NONCOMPETITION AGREEMENTS UNENFORCEABLE WHEN USED TO PREVENT EMPLOYEE MOBILITY BETWEEN CHARITABLE NONPROFITS

Because noncompetition agreements are at odds with the nature of the charitable nonprofit organization, and in light of the multitude of

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\$803.9 billion, while education-related organizations ranked second with \$240.3 billion in revenue. See Arnsberger & Graham, *supra* note 3, at 4–5 & fig.E (reporting statistics based on a sample of returns filed with the IRS by § 501(c)(3) organizations for the 2008 tax year). Neither the health nor education subsector receives significant amounts of private donations. See Boris & Steuerle, *supra* note 3, at 77 & figs.3.6, 3.7 (“[H]igher education and hospitals . . . differ from the rest of nonprofits in their limited reliance on private contributions.”); Brown & Slivinski, *supra* note 28, at 143 (citing B. Weisbrod, *Private Goods, Collective Goods: The Role of the Nonprofit Sector*, in K. Clarkson & D. Martin, eds., *THE ECONOMICS OF NONPROPRIETARY ORGANIZATIONS RESEARCH IN LAW AND ECONOMIC SUPPLEMENT 1* (1980)) (“[Private donations] tend to represent a greater fraction of revenues for nonprofit organizations providing collective consumption of goods, for which it is difficult to charge consumers, than for nonprofits such as universities and hospitals that provide goods with a significant component of private consumption.”). However, they do rely on money from the government. For example, over three-quarters of the health subsector’s revenues in 2000 were from Medicare and Medicaid. See Boris & Steuerle, *supra* note 3, at 74–75 & 76 fig.3.6 (citing The Urban Institute, NCCS/GuideStar National Nonprofit Database (2000)).

<sup>125</sup> See *Number and Percent of Faculty, Average Salary, Average Compensation, Average Benefits, and Percent of Faculty Tenured, by Category and Academic Rank, 2011–12*, AAUP.ORG, [www.aaup.org/NR/rdonlyres/B920A441-FE70-4B7D-B3B2-99DE5CC02F9C/0/Tab13.pdf](http://www.aaup.org/NR/rdonlyres/B920A441-FE70-4B7D-B3B2-99DE5CC02F9C/0/Tab13.pdf) (last visited May 3, 2014) (showing that 54.5% of faculty members at ranked academic institutions are tenured as of 2011–12); Adams, *supra* note 120, at 81 (stating that “the tenure decision is based principally on the candidate’s record of teaching, scholarship, and service”).

<sup>126</sup> The tenure-like system would, of course, need to be adapted to the specific industry in which the charitable nonprofit is engaged, taking into account professional obligations and expectations.

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alternative forms of protection available to those institutions, noncompetition agreements should be considered unenforceable when used to prevent individuals from leaving one charitable nonprofit to work for another. There are two main avenues through which this goal could be accomplished: state legislatures could amend the statutes currently governing noncompetition agreements, or Congress could issue a federal mandate.<sup>127</sup> While the first option maintains continuity with the current legal framework, the second option—a federal statute—would be the most efficient choice and would provide the highest level of uniformity in the law.

As discussed above, the validity of employee noncompetition agreements is governed primarily by state statute.<sup>128</sup> Thus, incorporating a provision that renders unenforceable specific types of noncompetition agreements would fit seamlessly into the current system. However, states' legislative processes can take years and would require the mobilization of lobbyists and supporters in each state to put the process in action.<sup>129</sup> Moreover, even assuming a similar bill was introduced and supported in each state (in actuality, it is likely that the language would *not* be uniform), the various states' legislative processes move at different speeds and would produce results at varying times.<sup>130</sup> This

<sup>127</sup> See Robert C. Hayden, *Non-competition Issues for Multistate Employers*, EMP. REL. L.J. 52, 58 (Summer 2004) (discussing the possible solutions for changing the laws governing the enforceability of employee noncompetition agreements). Congress's authority to implement such a law stems from the Commerce Clause of the U.S. Constitution, which gives Congress the power to regulate interstate commerce. Loren W. Brown, *Credit Report: An Acceptable Aid to the Hiring Decision?*, 39 W. ST. U. L. REV. 1, 15 (2011); Timothy J. Coley, *Getting Noticed: Direct and Indirect Power-Allocation in the Contemporary American Labor Market*, 59 CATH. U. L. REV. 965, 989 (2010); see U.S. CONST. art. I, § 8, cl. 3 ("The Congress shall have Power . . . To regulate Commerce . . . among the several States . . .").

<sup>128</sup> See *supra* notes 86–88 and accompanying text.

<sup>129</sup> See Hayden, *supra* note 126, at 58–59 (describing "state-by-state change in the law" as "a glacial process"). For example, a brief overview of the legislative process in Minnesota (the Author's home state) is as follows: an individual or organization proposes a law and finds a legislator to sponsor the law, the legislative staff translates the idea into proper form, the proposed law (now a "bill") is introduced to the House and Senate and referred to one or more committees, the committee members discuss the bill and invite public comment, the committees vote on the bill, bills that are approved by the committees move to the full bodies for a vote, and, finally, bills that pass both the House and the Senate go to the governor for approval. See Minnesota House of Representatives Public Information Services, *State Law Process*, MINNESOTA STATE GOVERNMENT SERIES, 1, 1-3 (Jun. 26, 2013), [www.house.leg.state.mn.us/hinfo/govser/GOVSER6.pdf](http://www.house.leg.state.mn.us/hinfo/govser/GOVSER6.pdf). Bills that do not complete the process in the course of one legislative session can be held over to the next year. See *id.* at 4.

<sup>130</sup> Even use of a uniform or model act, such as those drafted by the Uniform Law Commission, would not produce significantly different results in this instance. Those acts are "years in the making" and must be approved by at least twenty states before they can be considered for adoption by state legislatures. *ULC Drafting Process*, UNIFORM LAW COMMISSION,



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would compound the frustration already felt by multi-state employers who must deal with the current state of non-uniformity among the jurisdictions in which they do business.<sup>131</sup>

The more prudent course of action would be for Congress to speak out. Use of a federal law would ensure uniformity and eliminate the confusion that currently surrounds the various state laws, thereby putting all charitable nonprofits on an even playing field regarding this issue. Moreover, the process for enacting the law would be comparatively easy,<sup>132</sup> as would enforcement—to the extent the federal law conflicted with a state’s law governing noncompetition agreements, the federal law would control.<sup>133</sup>

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[www.uniformlaws.org/Narrative.aspx?title=ULC Drafting Process](http://www.uniformlaws.org/Narrative.aspx?title=ULC%20Drafting%20Process) (last visited April 15, 2013). And, while uniform acts are to be adopted “exactly as written,” model acts are merely guidelines “which states can borrow from or adapt to suit their individual needs and conditions.” *Id.* Thus, lack of uniformity in the law still could be an issue.

<sup>131</sup> See Hayden, *supra* note 126, at 58 (“The differing approaches to non-competition agreements among the states results in an uneven playing field that will often give a significant unfair advantage to competitors that have substantial operations in states friendly to non-competition agreements, while significantly disabling competitors with the bulk of their operations in states hostile to such agreements.”); Hutter, *supra* note 58, at 343 (“It is a valid possibility that an employee non-competition agreement which is enforceable in one state may nevertheless be ruled void in another state and in still a third state be modified to be reasonable and then enforced.”); Bishara, *supra* note 68, at 289 (“[E]ach state has its own laws concerning covenants not to compete, which can cause problems for employers and employees who have business locations across the country.”).

<sup>132</sup> See Hayden, *supra* note 127, at 59 (“Federalizing the non-competition laws, on the other hand, requires just one set of laws to be passed by just two bodies—the Senate and the House of Representatives. Of course the members of both the House and the Senate represent the states and localities in which they are elected, but they also have an obligation to look at issues from a national, as opposed to state or local, view. Therefore, they may be far less resistant to the idea of change.”).

<sup>133</sup> This proposition is based on the notion of federal preemption found in the Supremacy Clause of the U.S. Constitution. Pursuant to the Supremacy Clause, the “Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.” U.S. CONST. art. VI, cl. 2. The U.S. Supreme Court has recognized three types of preemption under which state law may be displaced by federal statute: express preemption, implied field preemption, and implied conflict preemption. See, e.g., Susan Crile, Comment, *A Minor Conflict: Why the Objectives of Federal Sex Trafficking Legislation Preempt the Enforcement of State Prostitution Laws Against Minors*, 61 AM. U. L. REV. 1783, 1798–99 (2012) (citing *English v. Gen. Elec. Co.*, 496 U.S. 72, 78–79 (1990); *Arizona v. United States*, 132 S. Ct. 2492, 2501 (2012); *Medtronic, Inc. v. Lohr*, 518 U.S. 470, 486 (1996); *Silkwood v. Kerr-McGee Corp.*, 464 U.S. 238, 248 (1984)); Caleb Nelson, *Preemption*, 86 VA. L. REV. 225, 226 (2000). “‘Express’ preemption occurs when a federal statute includes a preemption clause explicitly withdrawing specified powers from the states.” Nelson, *supra*, at 226. Implied field preemption occurs when a federal regulatory scheme is “‘so pervasive’ that there is ‘no room’ for state law.” Crile, *supra*, at 1799 (quoting *Pennsylvania v. Nelson*, 350 U.S. 497, 502 (1956)). And, implied conflict preemption “occurs when state and federal legislation are in conflict, either because compliance with both laws is impossible or because the state law frustrates the federal law’s purposes.” *Id.* (citations omitted). Thus, “to the extent a federal [law] governs an activity, there can

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The main issue with this approach is where the provision should be located. While Congress has enacted many laws related to the employer-employee relationship, governing everything from minimum wage requirements to an employee's right to join a union, none of those statutes seems like the right place for a provision relating to the enforceability of noncompetition agreements issued by charitable nonprofits.<sup>134</sup> Rather, the premise of this Article—that enforceability of these agreements should turn on the nature of the employer—suggests the proper place for the provision is within the portion of the federal tax code that grants charitable nonprofits their tax-exempt status. Thus, in addition to enumerating in subsection (c) of 26 U.S.C. § 501 the conditions necessary for attaining charitable nonprofit status (and the attendant tax benefits), Congress should include a new subsection (t) as follows:

(t) Restriction on use of noncompetition agreements. An organization which is described in subsection (c)(3), and which is exempt from taxation under subsection (a), shall not use a noncompetition agreement to prevent a former employee from engaging in employment for any other organization which is described in subsection (c)(3) and which is exempt from taxation under subsection (a). Noncompetition agreements used in such a manner are unenforceable *per se*.<sup>135</sup>

This location will help to ensure that there is no confusion as to which entities are affected by the provision, and—most importantly—this location is most directly tied to the reasons for enacting the provision in the first place—i.e., ensuring charitable nonprofits are acting in

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be no contrary state or local law. Nevertheless, federal and state laws concerning the same basic interest can coexist so long as the state laws are not in any serious manner contradictory.” Brown, *supra* note 126, at 15–16.

<sup>134</sup> See Hayden, *supra* note 127, at 59 (stating that there is “plenty of precedent for federalization in the employment context,” including the National Labor Relations Act, the Fair Labor Standards Act, and Title VII of the Civil Rights Act of 1964); Coley, *supra* note 126, at 990 (“Through its Commerce Clause powers, Congress has implemented a variety of federal legislative initiatives that fall under the broad umbrella of labor and employment policy; these include . . . free trade agreements, . . . mandated minimum wage and improved workplace conditions, family and medical leave, . . . and a host of anti-discrimination laws.”) (citations omitted); see also Fair Labor Standards Act, 29 U.S.C. §§ 201–219 (2012) (governing minimum wage requirements); National Labor Relations Act, 29 U.S.C. §§ 151–169 (2012) (governing collective bargaining).

<sup>135</sup> This language should serve to preempt contrary state law through implied conflict preemption. See *supra* note 133 and accompanying text. However, to eliminate any confusion, Congress could choose to expressly preempt inconsistent state law by adding the following language to the end of the proposed subsection (t): “This provision preempts any State or local law insofar as the State or local law permits the use of noncompetition agreements as prohibited herein.”

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accordance with their missions. Without a law like this in place, charitable nonprofits will be able to continue enjoying the best of both the for-profit and nonprofit worlds.

## CONCLUSION

“[T]he business of contributing to the public good . . . [is] arguably the primary principle that motivates the nonprofit enterprise,”<sup>136</sup> thereby greatly differentiating such entities from their for-profit counterparts. That is especially true in the case of the charitable nonprofit. In return, charitable nonprofits receive billions of dollars worth of tax exemptions from the government and donations from individuals that allow them to stay in business while pursuing their altruistic missions. Thus, charitable nonprofit organizations operate in a non-traditional competitive environment that rewards good deeds, albeit at a “considerable social cost.”<sup>137</sup>

Despite their unique situation and the benefits already bestowed upon them, charitable nonprofits have the ability to use noncompetition agreements to their advantage in the marketplace. Noncompetition agreements, which prevent employees from leaving one entity to work for another in a similar capacity for a certain period of time after termination of employment, are borne out of a desire to maximize profits and prevent competition in a traditional competitive environment. They should not be used in the non-traditional competitive environment inhabited by charitable nonprofits. Rather, allowing one charitable nonprofit to prevent a former employee from working for another charitable nonprofit is contrary to the charitable nonprofit’s mission and tax-exempt status. Moreover, alternative and less intrusive means of protecting an employer’s interests exist. Thus, Congress should enact a law rendering noncompetition agreements unenforceable to the extent they are used to prevent employee mobility between charitable nonprofit organizations.

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<sup>136</sup> Minkoff & Powell, *supra* note 27, at 591.

<sup>137</sup> COLOMBO & HALL, *supra* note 8, at 7.